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No. 05-

IN THE

Supreme Court of the United States

KEVIN ADELL,

Petitioner,

v.

JOHN RICHARDS HOMES BUILDING COMPANY, L.L.C.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Rule 802 of the Federal Rules of Evidence generally proscribes the admission of hearsay to establish relevant facts. Rule 703 permits an expert witness to base an opinion on facts "made known to the expert" by others, and Rule 705 provides that the expert may be required to explain the facts relied upon in forming his or her opinion. Five courts of appeals have held that, although an expert witness may offer opinions based on hearsay, the expert's statement of, or reliance upon, the hearsay does not establish the hearsay as an admissible fact for other purposes. *See, e.g., In re James Wilson Assocs.*, 965 F.2d 160, 173 (7th Cir. 1992) ("The fact that inadmissible evidence is the (permissible) premise of the expert's opinion does not make that evidence admissible for other purposes, purposes independent of the opinion."). Accordingly, the party with the burden of proof still bears the burden of establishing the relevant fact in some other way if necessary to the party's case. *Id.* In contrast, the court below, following a decision by another court of appeals, held that, if the hearsay fact is stated or relied upon by the expert, the burden shifts to the opposing party to disprove the fact through cross-examination. *See In re John Richards Homes Bldg Co.*, 439 F.3d 248, 264 (6th Cir. 2006); Pet. App. at 29a-30a. The question presented is:

Should the Court grant certiorari to resolve a conflict among the courts of appeals on the question whether a party with the burden of proof may establish a fact through the hearsay testimony of an expert witness?

PARTIES TO THE PROCEEDINGS

The Petitioner is Kevin Adell, an individual. The Respondent is John Richards Homes Building Company, L.L.C.

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PRELIMINARY STATEMENT

This matter arises out of the involuntary bankruptcy case of respondent John Richards Homes Building Company, L.L.C. ("JRH"), which was commenced by petitioner Kevin Adell ("Adell") on June 24, 2002 pursuant to section 303(b) of the Bankruptcy Code. 11 U.S.C. § 303(b). Prior to the bankruptcy filing, JRH was in the business of constructing homes. After the bankruptcy court dismissed the case on the ground that JRH disputed its debt to Adell, JRH sued Adell in the bankruptcy court, asserting that Adell had commenced the involuntary case in bad faith and seeking damages under section 303(i) of the Bankruptcy Code. 11 U.S.C. § 303(i). The bankruptcy court ultimately found Adell liable and awarded JRH a judgment against Adell under section 303(i) in the amount of $6,413,230.68 (the "Judgment"). This Judgment is by far the largest ever awarded under section 303(i), and represents approximately $305,391 per day for each day JRH spent in bankruptcy.[1]

At trial, JRH sought to prove its claim for damages by attempting to show that, as a result of the involuntary bankruptcy, it suffered lost profits owing to a reduction in sales. To prove its claim for lost profits, JRH undertook to establish the existence of historic sales of homes, together with alleged profits derived from these sales.[2] At trial, however, JRH did not offer any fact witness

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[1] Because the amount of the Judgment greatly exceeded the value of Adell's assets, Adell was forced to commence his own bankruptcy proceeding. Adell has since paid the Judgment with funds obtained from a relative.

[2] In order to establish a claim for lost profits, JRH clearly had the burden of demonstrating sales and profits claimed to have been lost as a result of the involuntary bankruptcy. *See* RESTATEMENT (SECOND) OF TORTS § 912(d) (1979) (to demonstrate lost profits, plaintiff "must introduce evidence of the amount of earnings received prior to the time of the injury"); 26 AM. JUR. 3D *PROOF OF FACTS* § 23 (2005) ("While it is not necessary that the amount of lost profits be established with mathematical

to establish the existence of any historic sales or profits. Instead, JRH offered the expert testimony of Thomas Frazee, an accountant hired to perform mathematical calculations regarding JRH's lost-profits claim. Frazee did not have any first hand knowledge of any prior sales or profits. Rather, he simply performed calculations based upon uncorroborated sale and profit information given to him by JRH. Apx. 571, 604-07, 609-11, 636-37.[3] Frazee's testimony regarding JRH's historic profits was clearly based on inadmissible hearsay.

Rule 802 of the Federal Rules of Evidence generally proscribes the admission of hearsay, and applies in bankruptcy proceedings. *See* Fed. R. Bankr. P. 9017 (incorporating the Federal Rules of Evidence in bankruptcy cases). At trial, Adell duly objected on hearsay grounds to the admissibility of Frazee's testimony to establish any lost sales or profits. Apx. 581-84. Adell also moved for judgment on the basis that JRH failed to meet its burden of demonstrating lost sales or profits. Apx. 868-72. The bankruptcy court denied Adell's motion and ultimately entered the Judgment in favor of JRH, and the district court affirmed.

On further appeal, the Sixth Circuit rejected Adell's argument that JRH could not rely on Frazee's testimony to establish as fact the existence of historic sales and profits. The Sixth Circuit acknowledged that JRH "bore the burden of proving [its claim for damages] to a reasonable degree of certainty." Pet. App. 29a. The court also recognized that "expert testimony may not be used to establish underlying facts not otherwise in evidence." Pet. App. 29a. Nevertheless, rather than conclude that JRH failed to meet its

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precision, the plaintiff is not released from its duty to present the factual basis for its allegations. Consequently, the plaintiff must provide the data on which its calculations and projections of lost profits are based."); *see also Lindevig v. Dairy Equip. Co.*, 442 N.W.2d 504, 508 (Wis. Ct. App. 1989) ("Assertions as to the amount of lost profits have no evidentiary value unless supported by figures showing profits and losses.").

[3] References to "Apx." are to the Appendix of the Record filed with the Sixth Circuit below.

burden of establishing as fact the existence of past sales and profits necessary to prove its lost-profits claim, the court held that JRH had met its burden because Adell failed to *disprove* the facts underlying Frazee's testimony. The court stated: "Had JRH had an independent need to prove the past profits . . ., the present record might be inadequate. However, it did not." Pet. App. 29a. Instead, the court reasoned, once JRH offered Frazee's hearsay testimony, the burden shifted to *Adell* to demonstrate that the information that Frazee relied upon was wrong. Pet. App. 30a ("an opposing party who would challenge the facts underlying the expert's opinion must do so by cross-examination").

Adell *did* cross-examine Frazee (and other witnesses), and established that Frazee had no first-hand knowledge of whether the information that JRH gave him regarding historic sales and profits was, in fact, true. Apx. 636-37. Moreover, as Adell complained at trial and on appeal, JRH refused to comply with the discovery master's direction that JRH turn over to Adell information regarding past sales and profits. Apx. 94-95, 582-83. Nor did JRH introduce at trial any documents or other materials establishing any historic sales or profits. Accordingly, there was no way that Adell could *disprove* the existence of historic sales or profits through cross-examination because JRH did not provide the information to Adell and Frazee had no way of knowing whether the information that JRH gave him was true or not. Thus, by applying its burden-shifting rule, the Sixth Circuit ensured that Adell was entirely at the mercy of whatever hearsay statements Frazee made regarding alleged historic sales and profits.

Further, there was no way, other than by relying on Frazee's testimony, that the bankruptcy court could have determined that JRH ever had any historic sales or profits on which to base its damage award because JRH offered no other evidence of historic sales or profits. In fact, the bankruptcy court clearly relied on Frazee's testimony in reaching its determination regarding lost sales and profits. Pet. App. 98a-100a.

The decision of the Sixth Circuit deepens an existing conflict among the courts of appeals concerning whether a party with the burden of proof may rely on the hearsay testimony of an expert

witness to establish facts that are not in evidence. The Fifth, Seventh, Eighth, Ninth, and Tenth Circuits reject the Sixth Circuit's approach. *See, e.g., TK-7 Corp. v. Estate of Barbouti*, 993 F.2d 722, 732 (10th Cir. 1993) ("The fact that Dr. Boswell relied upon the report [of Werber] in performing his calculation of lost profits did not relieve the plaintiffs from their burden of proving the underlying assumptions contained in the report."); *South Central Petroleum, Inc. v. Long Bros. Oil Co.*, 974 F.2d 1015, 1019 (8th Cir. 1992) ("When the district court admitted the exhibit, however, it limited the admission to the expert's opinion, and not to the underlying figures, as required by Federal Rule of Evidence 703."); *In re James Wilson Assocs.*, 965 F.2d 160, 173 (7th Cir. 1992) ("The fact that inadmissible evidence is the (permissible) premise of the expert's opinion does not make that evidence admissible for other purposes, purposes independent of the opinion."); *Paddack v. Dave Christensen, Inc.*, 745 F.2d 1254, 1261-62 (9th Cir. 1984) ("Rule 703 merely permits such hearsay, or other admissible evidence, upon which an expert properly relies, to be admitted to explain the basis of the expert's opinion. It does not allow the admission of the reports to establish the truth of what they assert."); *Fox v. Taylor Diving & Salvage Co.*, 694 F.2d 1349, 1356 (5th Cir. 1983) ("An expert is permitted to disclose hearsay for the limited purpose of explaining the basis for his expert opinion, Fed. R. Evid. 703, but not as general proof of the truth of the underlying matter, Fed. R. Evid. 802.").

In contrast, in applying its burden-shifting rule, the Sixth Circuit expressly followed the approach taken by the First Circuit in *International Adhesive Coating Co. v. Bolton Emerson Int'l, Inc.*, 851 F.2d 540, 544-45 (1st Cir. 1988). *See* Pet. App. at 29a-30a. In addition to deepening a conflict among the courts of appeals, the Sixth Circuit's decision also conflicts with prior decisions of this Court. Further, the question presented is important and recurring, and has engendered confusion among the lower courts. Finally, the decision of the Sixth Circuit is plainly wrong, and this case presents an ideal vehicle to address the question presented because the question is squarely presented and is outcome determinative. Accordingly, certiorari is warranted.

OPINIONS BELOW

The opinion of the court of appeals is reported at 439 F.3d 248. Pet. App. 1a. The opinion of the district court is reported at 312 B.R. 849. Pet. App. 50a. The opinion of the bankruptcy court is reported at 291 B.R. 727. Pet. App. 83a.

JURISDICTION

The court of appeals entered its judgment on March 1, 2006. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

RELEVANT PROVISIONS OF LAW

Rules 802, 703, and 705 of the Federal Rules of Evidence, 28 U.S.C. §§ 802, 703, & 705, are reproduced in the appendix. Pet. App. 111a.

STATEMENT

A. Background

On December 28, 2001, Adell and JRH entered into a contract for the construction of a home for Adell in Bloomfield Hills, Michigan (the "Property"). Apx. 825. In January and February 2002, Adell paid JRH $1,237,435.90, and an additional $621,319.56 was drawn from a line of credit held by Adell to satisfy an existing mortgage on the Property. Apx. 789. While much of this amount was used to purchase the Property, JRH, through its principal, John Shekerjian, admitted that at least $133,000 was to be used for the construction of Adell's home and that, under Michigan law, this $133,000 was required to be held in trust for the benefit of Adell. Apx. 677-79. By the end of May 2002, no construction had commenced other than preliminary excavation for the basement, which remained flooded with water. Apx. 653, 923.

B. Events Leading To The Involuntary Bankruptcy Case

Adell investigated JRH's financial condition prior to filing the involuntary bankruptcy petition. From Deborah Bjorkly, an

employee of one of several JRH-related entities (the "Affiliates"), Adell learned about JRH's precarious financial situation, JRH's problems with trade creditors, and other problems with the Property. Bjorkly, a former police officer, was the "selections coordinator" for the construction of Adell's home. Apx. 881-82. Bjorkly told Adell of the apparent financial problems of JRH and the Affiliates, and testified that she told Adell that trade creditors were complaining that they were not being paid and that customers were complaining of liens being placed on their properties. Apx. 889-91. Bjorkly informed Adell of the identity of subcontractors and trade creditors that had not been paid. Apx. 889, 897-900.

Prior to leaving her job in April 2002, Bjorkly had decreased her hours from full-time to part-time because there were no new home sales and there was not enough work to keep her employed on a full-time basis. Apx. 901. At the time, Shekerjian and his wife were overseeing work on a large dwelling the Affiliates were constructing for them, a 12,000 square-foot mansion known as the "DSO house," Apx. 893, 518, which witnesses explained had financially overextended the Affiliates, Apx. 952. Bjorkly noted that Shekerjian was diverting resources from other projects to the DSO house. Apx. 893-94. Another witness testified that, as of the time of trial, the land for the DSO house still was not paid for. Apx. 522.

In May 2002, Adell also spoke with William Seklar, a former employee of the Affiliates, who testified regarding the Property and JRH's financial situation. Apx. 953-65. Seklar explained that the Affiliates "were having difficulties in completing clients' homes, difficulties in paying trades, difficulties in getting trades to respond to us to work on the client residences. There was [sic] liens put on customers clients' homes. And it was making it extremely difficult not only with potential clients, but also current clients." Apx. 950.

After learning of these problems and the precarious financial condition of JRH and the Affiliates, Adell asked Shekerjian for his money back. Apx. 912, 908. Shekerjian, however, told Adell that he did not have the funds. Apx. 912, 921. After investigating the matter, Adell's counsel informed Adell that the checks that he had

written for the construction of his home had not gone to JRH, but to other corporate entities. Apx. 913, 938.

On June 6, 2002, Adell commenced a lawsuit against JRH in state court in Oakland County, Michigan. Apx. 735-43. Among other things, Adell alleged breach of contract and a violation of the Michigan builders trust fund law, based upon JRH's failure to deposit the funds that Adell had advanced for construction of the home into a trust account in the name of JRH. Apx. 735-43.

C. The Proceedings Below

1. The involuntary bankruptcy case

On June 24, 2002, Adell commenced the involuntary bankruptcy case against JRH under chapter 7 of the Bankruptcy Code, 11 U.S.C. § 101, *et seq*. Apx. 28. JRH moved to dismiss the involuntary case on July 1, 2002. Apx. 30. On July 12, 2002, three additional creditors joined the involuntary petition against JRH but just three days later, on July 15, 2002, the bankruptcy court dismissed the case on the ground that JRH's debt to Adell was in "bona fide dispute." Apx. 33, 74.

2. JRH's section 303(i) action

Following dismissal of the involuntary case, JRH pursued a proceeding in the bankruptcy court against Adell pursuant to section 303(i) of the Bankruptcy Code, 11 U.S.C. § 303(i), alleging bad faith in filing the involuntary case. Apx. 30. Adell sought discovery of the financial records of the Affiliates, but JRH objected to this request and the bankruptcy court did not require that JRH respond. Apx. 94. After JRH disclosed Thomas Frazee as its witness on the calculation of damages (and it became clear that JRH intended to base its damage claim on the financial performance of the Affiliates), a court-appointed discovery master directed JRH to produce the financial information of the Affiliates that Adell had requested. Apx. 582. At trial, JRH presented two witnesses on the question of damages: Frazee (expert witness) and Shekerjian (fact witness). Adell objected to Frazee's testimony on the ground that JRH had still failed to produce the financial

information underlying Frazee's evaluation, but the bankruptcy court overruled the objection. Apx. 581-85.

a. The testimony of Thomas Frazee

Frazee is a certified public accountant who conducted a mathematical evaluation of JRH's claim for lost profits and testified as an expert witness. Apx. 189, 563, 565-66. Frazee calculated JRH's damages as being between $4.1 million and $6 million. Apx. 571. In making his calculations, Frazee looked at several categories of information, including financial records for JRH and "individual profit and loss calculations for a number of different homes that have been constructed by [JRH and the Affiliates] over the last five years." Apx. 566-67. Frazee did not testify as a fact witness about any actual sales, profits, financial performance, or financial records of JRH or the Affiliates. Moreover, although Frazee's opinion treats as established facts what JRH told him about the current financial condition and past performance of JRH and the Affiliates, none of this information was admitted into evidence at trial. Apx. 636-37 (Shekerjian indicated that the numbers Frazee used were those that "we gave him."). Frazee's opinion thus assumes as its very foundation that certain things told to him -- highly relevant and contested financial data of both JRH and the Affiliates -- are correct and established facts.

At the conclusion of Frazee's testimony, JRH moved that his written report be admitted into evidence. Apx. 580-81. Adell moved to strike Frazee's testimony in its entirety and objected to the admission of the written report as hearsay. Apx. 581. The bankruptcy court denied the motion to strike Frazee's testimony without prejudice but advised that the premises underlying Frazee's calculations would have to be established by fact witnesses. Apx. 582. The court also sustained Adell's objection to the admissibility of Frazee's written report, concluding (as JRH conceded) that the report was hearsay. Apx. 584.

b. The testimony of John Shekerjian

Like Frazee, Shekerjian provided no testimony regarding the profits of JRH or of any of the Affiliates, upon which JRH's

damage claim is based, sufficient to support the Judgment. He provided no testimony as a fact witness regarding any actual sales, revenues, expenses, profits of JRH or the Affiliates, financial reports for these entities, or even concerning whether the Affiliates were ever profitable at all. He offered no basis from which to conclude that the key information or assumptions underlying Frazee's computation of damages were valid, accurate, or reasonable, and did not even verify that the numbers Frazee used were accurate. Apx. 634. Indeed, Shekerjian offered no explanation whatsoever, and indicated that he had never even reviewed the underlying data or information that had been given to Frazee, stating: "I'm not in the accounting side of the business at all." Apx. 668.

c. Adell's motion for judgment

At the conclusion of JRH's case, Adell moved for judgment, arguing that the evidence failed to demonstrate bad faith or that JRH was entitled to punitive damages. Apx. 862-67, 872. As to compensatory damages, Adell argued that JRH had failed to introduce any factual evidence or data demonstrating actual sales, revenues, expenses, or profits; that JRH had failed to establish proximate cause or any reasonable basis for the conclusion that JRH would suffer lost sales of four homes per year for five years; and that JRH's damage claim was entirely speculative in nature and was based solely on unsubstantiated presumptions. Apx. 868-72. The court denied Adell's motion. Apx. 879.

At the conclusion of trial, Adell again argued that the record demonstrated that he had acted in good faith; that JRH had not proved damages; and that JRH had not proved that anything that Adell had allegedly done proximately caused harm to JRH. Apx. 1012-21.

d. The Judgment

On April 25, 2003, the bankruptcy court awarded JRH the Judgment in the amount of $6,413,230.68, relying upon Frazee's testimony in assessing damages. Apx. 195; Pet. App. 83a. The bankruptcy court entered the Judgment, even though it recognized that Frazee's calculations assumed various facts -- including

historical profit margins, future home sale prices, and the number of homes to be sold. Pet. App. 98a-99a.

On appeal, the district court affirmed. Pet. App. 51a. With respect to damages, the district court noted that Frazee's testimony was based on "the total sales and profit margins of Mr. Shekerjian's JRH-related entities," but did not address the fact that there was no record evidence to support the assumptions concerning the Affiliates upon which Frazee based his analysis. Pet. App. 70a.

On further appeal, the Sixth Circuit affirmed. With respect to damages, the Sixth Circuit recognized that "JRH's expert utilized the past profits of the Affiliates to estimate JRH's future lost profits and then testified accordingly." Pet. App. 29a. In response to Adell's argument (presented in all three lower courts) that "the bankruptcy court should not have accepted that testimony absent actual evidence in the record of the Affiliates' past profits," the Sixth Circuit stated that experts may generally offer opinions based on facts beyond the record, and that "an opposing party who would challenge the facts underlying the expert's opinion must do so by cross-examination" alone. Pet. App. 30a. As discussed, however, JRH refused to produce the very information upon which Adell would have based any such cross-examination.

REASONS FOR GRANTING THE PETITION

The decision of the court below deepens an existing circuit split on the question whether a party with the burden of proof may rely on the hearsay statement of an expert witness to demonstrate a relevant fact not in evidence. Rule 802 of the Federal Rules of Evidence generally proscribes the admission of hearsay to establish relevant facts, and five courts of appeals have held that a party with the burden of proof may not circumvent this rule by relying on the hearsay statements of experts. Instead, if the party has the burden of establishing a relevant fact, the party must do so independently of the hearsay statements of an expert.

Rule 703 of the Federal Rules of Evidence permits an expert witness to base an opinion on facts "made known to the expert" by others, and Rule 705 permits an expert to explain the basis of an

opinion "without first testifying to the underlying facts," but provides that the expert may be required to disclose underlying facts on cross-examination. Nothing in rules 703 or 705 overrides Rule 802. Nevertheless, two courts of appeals -- the Sixth Circuit in this case and First Circuit -- have concluded that a party with the burden of proof may rely on the hearsay statement of an expert witness to establish a relevant fact, and that the burden shifts to the opposing party to disprove the particular fact through cross-examination.

The decision of the court below, effectively concluding that Rules 703 and 705 create an exception to Rule 802, is contrary to prior precedent of this Court establishing that, absent ambiguity, an absurd result, or a conflict with the manifest intent of the drafters, the Federal Rules of Evidence must be applied as written. By its plain terms, Rule 802 precludes reliance on hearsay to establish, through experts, facts not in evidence. By their plain terms, Rules 703 and 705 do not create exceptions to Rule 802 for expert statements. Where, as here, the terms of the relevant rules are plain, they must be followed.

Further, the decision of the court below is dead wrong. Rule 703 simply provides that experts may rely on hearsay in forming their opinions. It does not provide that any hearsay on which the expert relies is itself admissible to establish a relevant fact. Rule 705 simply provides that the expert may testify regarding his or her opinions and the reasons therefor prior to testifying about any underlying facts. Like Rule 703, it does not provide that any hearsay on which the expert relies becomes admissible factual evidence. There is no reason to conclude that either Rule 703 or Rule 705 somehow shifts the evidentiary burden to the opposing party to disprove hearsay statements through cross-examination.

The question presented is raised squarely in this case, and is outcome determinative. As the decision below acknowledged, JRH had the burden of proving alleged historic sales and profits. Because JRH offered no evidence of historic sales or profits other than Frazee's hearsay statements, its damage claim fails. On cross-examination, Adell demonstrated that Frazee had no first-hand knowledge of any historic sales or profits, and that he had simply

relied upon information that JRH had given to him. But the Sixth Circuit required more: that Adell *disprove* Frazee's hearsay statements through cross-examination. Among other things, this rule fundamentally misperceives the role of cross-examination. Given that Adell objected to the admission of Frazee's statements as hearsay, the trial court should have excluded his testimony for purposes of establishing historic sales and profits. Simply put, it was not Adell's burden to disprove a fact that JRH had failed to establish.

A. The Decision Below Deepens A Circuit Conflict.

The Sixth's Circuit's decision in this case conflicts irreconcilably with decisions of the Fifth, Seventh, Eighth, Ninth, and Tenth Circuits.

In *In re James Wilson Assocs.*, 965 F.2d 160 (7th Cir. 1992), the particular fact in dispute was the condition of a building, which was examined by an engineer who did not testify. The engineer, however, relayed his observations to an architect who did testify as an expert. Although the architect could properly explain the basis for his own opinion, including any information received from the engineer, his testimony could not be used to establish as "fact" the condition of the building.

> The issue was the state of the building, and the expert who had evaluated that state -- the consulting engineer -- was the one who should have testified. The architect could use what the engineer told him to offer an opinion within the architect's domain of expertise, but he could not testify for the purpose of vouching for the truth of what the engineer had told him -- of becoming in short the engineer's spokesman.

965 F.2d at 173. Accordingly, the Seventh Circuit concluded that the architect's testimony was properly excluded as hearsay for the purpose of establishing the fact of the condition of the building. *Id.* at 172.

In reaching its conclusion, the Seventh Circuit reasoned that a trial court is obligated to "make sure that the expert isn't being used as a vehicle for circumventing the rules of evidence. The fact

that inadmissible evidence is the (permissible) premise of the expert's opinion does not make that evidence admissible for other purposes, purposes independent of the opinion." 965 F.2d at 173 (citation omitted). The court recognized that, in summarizing the facts on which he or she has relied, an expert does *not* thereby establish those facts as "facts." The court stated:

> An expert is of course permitted to testify to an opinion formed on the basis of information handed to rather than developed by him -- information of which he lacks first-hand knowledge and which might not be admissible in evidence no matter by whom presented. Fed. R. Evid. 703. And in explaining his opinion an expert witness normally is allowed to explain the facts underlying it, even if they would not be independently admissible. But the judge must make sure that the expert isn't being used as a vehicle for circumventing the rules of evidence. . . . If for example the expert witness (call him A) bases his opinion in part on a fact (call it X) that the party's lawyer told him, the lawyer cannot in closing argument tell the jury, "See, we proved X through our expert witness, A."

965 F.2d at 172-73; *see also Dura Automotive Sys. of Indiana v. CTS Corp.*, 285 F.3d 609, 615 (7th Cir. 2002) (following *James Wilson*); *Polythane Sys., Inc. v. Marina Ventures Int'l, Ltd.*, 993 F.2d 1201, 1207 (5th Cir. 1993) ("While revealing the basis for an expert's opinion is allowed, such disclosure does not facilitate the admission of otherwise inadmissible evidence."); *South Central Petroleum, Inc. v. Long Bros. Oil Co.*, 974 F.2d 1015, 1019 (8th Cir. 1992) ("When the district court admitted the exhibit, however, it limited the admission to the expert's opinion, and not to the underlying figures, as required by Federal Rule of Evidence 703."); *United States v. Grey Bear*, 883 F.2d 1382, 1393-94 (8th Cir. 1989) ("We are persuaded that Fed. R. Evid. 703 does not permit an expert witness to circumvent the rules of hearsay by testifying that other experts, not present in the courtroom, corroborate his views."); *Paddack v. Dave Christensen, Inc.*, 745 F.2d 1254, 1261-62 (9th Cir. 1984) ("Rule 703 merely permits such hearsay, or other admissible evidence, upon which an expert properly relies, to

be admitted to explain the basis of the expert's opinion. It does not allow the admission of the reports to establish the truth of what they assert."); *Fox v. Taylor Diving & Salvage Co.*, 694 F.2d 1349, 1356 (5th Cir. 1983) ("An expert is permitted to disclose hearsay for the limited purpose of explaining the basis for his expert opinion, Fed. R. Evid. 703, but not as general proof of the truth of the underlying matter, Fed. R. Evid. 802.").

In this case, the relevant facts were the historic sales and profits of JRH and the Affiliates. Frazee plainly lacked first-hand knowledge about these facts, and simply relied on information given to him by JRH. By admitting Frazee's testimony nevertheless, the Sixth Circuit improperly allowed Frazee to establish his hearsay statements as "facts" without proof.

In *TK-7 Corp. v. Estate of Barbouti*, 993 F.2d 722 (10th Cir. 1993), an expert based his opinion upon the hearsay opinion of another expert. 993 F.2d at 732. The issue was lost profits, and the "non-testifying expert" (Werber) had projected calculated sales projections that were relied upon by the "testifying expert" (Boswell). *Id.* Rejecting Boswell's testimony, the Tenth Circuit stated: "The fact that Dr. Boswell relied upon the report [of Werber] in performing his calculation of lost profits did not relieve the plaintiffs from their burden of proving the underlying assumptions contained in the report." *Id.* The court continued:

> Dr. Boswell professed no expertise with regard to projecting sales in Britain. He clearly adopted the projections of Mr. Werber. But there is no indication in the record that Dr. Boswell had any familiarity with the methods or reasoning used by Mr. Werber in arriving at his projections. In fact, when Dr. Boswell first submitted his opinion at the time of his deposition, he assumed the validity of the projections made by [Mr.] Werber despite the fact that he knew little or nothing at all about Werber. . . . Based upon the evidence presented in the trial court, Dr. Boswell's assumption of the Werber sales figures cannot be considered "reasonable reliance" for purposes of forming his own opinion of the amount of lost profits. A determination of profits for the joint venture was wholly

> dependent upon a projection of future sales. By assuming the sales projections made by Werber, Dr. Boswell in essence assumed the very matter at issue on which he was called to express his opinion.

993 F.2d at 732. Recognizing the inadequacy of cross-examination in such circumstances, the Tenth Circuit added that "Dr. Boswell's lack of familiarity with the methods and the reasons underlying Werber's projections virtually precluded any assessment of the validity of the projections through cross-examination of Dr. Boswell." *Id.* at 732-33.

In *Viterbo v. Dow Chem. Co.*, 826 F.2d 420 (5th Cir. 1987), plaintiff Viterbo claimed damages as a result of exposure to a chemical produced by defendant Dow. In support of his claim, Viterbo proffered the expert testimony of his doctor, Dr. Alfred Raymond Johnson. The district court, however, excluded Dr. Johnson's testimony because it "lacked objectivity in that he diagnosed Viterbo's condition as resulting from exposure to [the chemical] based only on the patient's oral history and without the benefit of medical tests." 826 F.2d at 422. The Fifth Circuit upheld this ruling, concluding: "If an opinion is fundamentally unsupported, then it offers no expert assistance to the jury." *Id.* The court then concluded: "Indeed, Dr. Johnson's testimony is no more than Viterbo's testimony dressed up and sanctified as the opinion of an expert. Without more than credentials and a subjective opinion, an expert's testimony that 'it is so' is not admissible." *Id.* at 424; *see also Zankich v. Santos*, 108 F.3d 1387 (table), No. 96-15530, 1997 WL 120795 at * 2-3 (9th Cir. Dec. 18, 1996) (concluding on motion for summary judgment that hearsay testimony included in expert affidavit was insufficient to establish genuine issue of material fact on element of claim); *Alevromagiros v. Hechinger Co.*, 993 F.2d 417, 421 (4th Cir. 1993) (discussing expert testimony on industry standards in product liability case, stating: "His comment that the advisory industry standards 'tragically' did not require the use of triangular braces does not constitute proof that industry standards are inadequate. It is merely another example of his own subjective opinion. Like the Fifth

Circuit, we are unprepared to agree that 'it is so if an expert says it is so.'") (citing *Viterbo*, *supra*).

The decision of the Sixth Circuit in this case clearly conflicts with the decisions of the courts of appeals discussed above. In addition, the decision below deepens an existing circuit conflict because the Sixth Circuit followed the approach adopted previously by the First Circuit.

In the decision below, the Sixth Circuit cited and relied upon the First Circuit's decision in *International Adhesive Coating Co. v. Bolton Emerson Int'l, Inc.*, 851 F.2d 540 (1st Cir. 1988), in which the buyer of equipment sued the manufacturer for damages for malfunctioning equipment. At trial, the court admitted the expert testimony of an accountant in support of the buyer's claimed losses. The expert claimed that his opinion was based upon business and financial records of the buyer and interviews with company personnel. 851 F.2d at 545. The manufacturer challenged the admission of the expert's testimony on the grounds that the testimony was speculative and lacked a factual basis, as required by Federal Rule of Evidence 703. Although it found the accountant's description of the business and financial records upon which he relied to form his opinion to be "sometimes abbreviated and conclusory," the First Circuit held that the trial court did not err in admitting the expert testimony, noting that "[w]hen the factual underpinning of an expert's opinion is weak, it is a matter affecting the weight and credibility of the testimony -- a question to be resolved by the jury." 851 F.2d at 545.

The approach followed by the First and Sixth Circuits impermissibly allows the trial court to abandon its critical gatekeeper function in favor of admitting hearsay through expert testimony and placing the burden upon the opposing party, through cross-examination, and the factfinder to assess the foundation of an expert's opinions and conclusions. As this case starkly illustrates, however, this approach allows the ultimate issue in the case -- here, the amount of damages supposedly based on historic sales and profits -- to be established solely on the strength of expert testimony based upon facts that have not been established by admissible evidence.

In addition to the conflict among the courts of appeals outlined above, numerous district courts have also adopted conflicting positions on the question presented. *Compare Loeffel Steel Prods., Inc. v. Delta Brands, Inc.*, 387 F. Supp. 2d 794, 808-809 (N.D.Ill. 2005) (expert report that relies on contributions of nontestifying experts is inadmissible); *Ninth Ave. Remedial Group v. Allis Chalmers Corp.*, 141 F. Supp. 2d 957, 959 (N.D. Ind. 2001) (same); *Kay v. First Cont'l Trading, Inc.*, 976 F. Supp. 772, 774 (N.D. Ill. 1997) (expert testimony lacking adequate foundation is inadmissible); *American Bearing Co. v. Litton Indus., Inc.*, 540 F. Supp. 1163, 1173-74 (E.D. Pa. 1982) (expert testimony lacking adequate foundation is inadmissible); *with Brown v. Wal-Mart Stores, Inc.*, 402 F. Supp. 2d 303, 309 (D. Me. 2005) (expert testimony would not be excluded for lack of foundation); *Orson, Inc. v. Miramax Film, Corp.*, 983 F. Supp. 624, 635 (E.D. Pa. 1997) (foundation of expert testimony goes to the credibility of testimony and is a matter for the jury), *rev'd on other grounds*, 189 F.3d 377 (3d Cir. 1999); *Janopoulous v. Harvey L. Walner & Assocs., Ltd.*, 866 F. Supp. 1086, 1095 (N.D. Ill. 1994) (expert testimony that relies in part on information supplied by a nontestifying expert is admissible).

The conflict and confusion among the courts of appeals and lower federal courts on the question presented is longstanding and unlikely to resolve itself absent intervention by this Court. Accordingly, certiorari is warranted.

B. The Decision Below Conflicts With Prior Precedent Of This Court And Is Plainly Wrong.

Like statutory enactments, the Federal Rules of Evidence are to be interpreted and applied in accordance with their terms. *Beech Aircraft Corp. v. Rainey*, 488 U.S. 153, 163 (1988) ("Because the Federal Rules of Evidence are a legislative enactment, we turn to the 'traditional tools of statutory construction,' in order to construe their provisions.") (citations omitted). Where, as here, the relevant terms of a rule are plain, judicial inquiry is complete and the rule must be applied as written. 488 U.S. at 163 ("We begin with the language of the Rule itself."); *see Connecticut Nat'l Bank v. Germain*, 503 U.S. 249, 254 (1992) ("When the words of a statute

are unambiguous, then, . . . 'judicial inquiry is complete.'") (quoting *Rubin v. United States*, 449 U.S. 424, 430 (1981)).

Rule 802 provides in pertinent part as follows: "Hearsay is not admissible except as provided by these rules." Because Frazee had no first-hand knowledge of any historic sales or profits, and because he simply relied upon the information that JRH gave to him in performing his calculations, Frazee's testimony regarding historic sales and profits constitutes classic hearsay. *See* Fed. R. Evid. 801 (defining "hearsay"); *see also Lee v. Illinois*, 476 U.S. 530, 543 n.4 (1986) (citing with approval E. Cleary, MCCORMICK ON EVIDENCE § 246, p. 584 (2d ed. 1972), and stating: "We have previously turned to McCormick's definition of hearsay as 'testimony in court, or written evidence, of a statement made out of court, the statement being offered as an assertion to show the truth of matters asserted therein, and thus resting for its value upon the credibility of the out-of-court asserter.'"). Because none of the exceptions to the hearsay rule even arguably apply in this case, Rule 802 plainly bars the admissibility of Frazee's testimony to establish historic sales or profits.

Rule 703 provides in pertinent part: "The facts or data in the particular case upon which an expert bases an opinion or inference may be those perceived by or made known to the expert at or before the hearing." Fed. R. Evid. 703. By its plain terms, nothing in Rule 703 provides that hearsay is admissible to establish a fact not in evidence simply because an expert relies on the hearsay. All that Rule 703 states is that the expert may rely upon hearsay in forming an opinion.

Rule 705 provides: "The expert may testify in terms of opinion or inference and give reasons therefore without first testifying to the underlying facts or date, unless the court requires otherwise." Fed. R. Evid. 705. The rule continues: "The expert may in any event be required to disclose the underlying facts or data on cross-examination." *Id.* By its plain terms, nothing in Rule 705 provides that hearsay is admissible to establish a fact not in evidence simply because an expert relies on it. All that Rule 705 provides is that the expert may testify about an opinion before

disclosing the facts underlying it, and that the expert may be compelled to disclose the factual basis for the opinion.

In construing Rule 705 to create an exception to Rule 802, the court below violated the plain-meaning rule in contravention of this Court's established methods of interpretation. Moreover, the decision below is just plain wrong, as there is no basis to conclude that Rule 802 means other than what it says, or that Rules 703 or 705 create an exception to it. Accordingly, certiorari is warranted.

C. This Case Presents An Ideal Vehicle To Resolve The Conflict Among The Courts of Appeals.

The question presented requires interpretation of the Federal Rules of Evidence, and can be resolved purely as a matter of law. Moreover, resolution of the question presented is outcome determinative. The only evidence of record concerning the critical issue of alleged historic sales and profits, as to which JRH had the burden of proof, is the hearsay introduced through Frazee's expert testimony. Absent the lower courts' treatment of this hearsay testimony as established facts, there would be no factual basis for the Judgment below -- in the amount of $6,413,230.68. Accordingly, certiorari is warranted.

CONCLUSION

For the foregoing reasons, Petitioner respectfully requests that the Court issue a writ of certiorari in this case.

Respectfully submitted,

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Dated: May 30, 2006

APPENDIX

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT DECIDED AND FILED MARCH 1, 2006

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 04-2154

In re JOHN RICHARDS HOMES BUILDING CO., L.L.C.,

Debtor.

KEVIN ADELL,

Plaintiff-Appellant,

v.

JOHN RICHARDS HOMES BUILDING CO., L.L.C.,

Defendant-Appellee.

Appeal from the United States District Court
for the eastern District of Michigan at Flint.
No. 03-40109–Paul V. Gadola, District Judge.

Argued: June 8, 2005

Decided and Filed: March 1, 2006

Before: NELSON and CLAY, Circuit Judges; OBERDORFER, District Judge.*

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* The Honorable Louis F. Oberdorfer, United States District Judge for the District of Columbia, sitting by designation.

Appendix A

OPINION

OBERDORFER, District Judge. After dismissing the involuntary bankruptcy petition filed by Kevin Adell against John Richards Homes Building Co., L.L.C. ("JRH"), the bankruptcy court found that the petition was filed in bad faith and awarded JRH costs, attorneys' fees, compensatory damages and punitive damages pursuant to 11 U.S.C. § 303(i) of the United States Bankruptcy Code. The district court affirmed that award. Adell now appeals that affirmance. Finding no error in the bankruptcy court's award or the district court's approval of it, we AFFIRM.

I. BACKGROUND

We set forth here an abbreviated version of the material events addressed by the bankruptcy court in adjudicating the merits of JRH's claim that Adell's petition for involuntary bankruptcy was in bad faith. A separate Appendix expands on these facts and summarizes more extensively the facts relating to the court's assessment of compensatory and punitive damages.

As the bankruptcy court found, in December 2001, Adell and JRH entered into a Residential Building and Purchase Agreement whereby JRH, in exchange for $3,030,000, agreed to sell Adell a 1.8 acre parcel of property in Bloomfield Hills, Michigan, and to construct a home for Adell on the property, with construction to begin "within a reasonable time after the completion of building plans and issuance of permits." Appendix ¶ ¶ 1-3. On February 28, 2002, the deal closed. The closing documents allocated $1,750,000 out of the $3,030,000 for the land purchase. *Id.* ¶ 4.

Over the next few months, Adell's relationship with JRH and its principal, John Shekerjian, soured. *Id.* ¶ ¶ 5-8. Adell began to complain about the pace of construction on his home and to contact JRH's former employees seeking negative information about JRH. He told Shekerjian that he wanted another builder to build his house and, apparently, barred JRH from the property. He also became upset about the amount he had paid for the land, contending that it was only worth $1 million instead of $1.75 million.

On June 6, 2002, after a number of conversations, meetings, letters and other interactions between Adell or his representatives and JRH or its representatives, Adell filed a civil suit against JRH and Shekerjian in the Oakland County Circuit Court. *Id.* ¶ ¶ 9, 10, 11, 12, 13, 14. The complaint included a number of claims, all of which essentially rested on two allegations: (1) that Shekerjian and JRH had *orally* told Adell that the land was worth $1,000,000, and that the home they would construct for him would have a value of $2,000,000, despite the fact that the executed sale documents allocated $1,750,000 to the value of the land, leaving at most $1,280,000 for the home construction; and (2) that Shekerjian for JRH had told Adell that construction would begin immediately after the sale closed, even though they knew that was impossible because there were "water problems" with the property, and that the resulting delay in commencing construction was not "reasonable." On June 18, 2002, JRH and Shekerjian jointly filed an answer, denying the substance of all of Adell's claims, stating affirmative defenses, and including a verified counter-complaint. *Id.* ¶ 18.

Appendix A

During the time between when Adell filed his state court civil suit and JRH and Shekerjian filed their responsive pleadings, Adell contacted at least two of JRH's contractors, telling them that JRH was in financial trouble and trying to persuade them to join him in filing an involuntary bankruptcy petition against JRH. *Id.* ¶ ¶ 15-16. Both refused. *Id.*

On June 24, 2002, less than a week after JRH and Shekerjian filed their responses in the state court case and without any further discussion or communication, Adell, as the sole petitioning creditor, filed an involuntary bankruptcy petition against JRH pursuant to 11 U.S.C. § 303(b)(2). *Id.* ¶ 20. According to the petition, Adell's own claim against JRH for fraud and breach of contract was in the amount of $800,000. *Id.* Adell sought to maximize the publicity attending his filing by hiring a public relations firm, Marx Layne, to publicize alleged defects in JRH's performance of its construction and financial obligations. *Id.* ¶ ¶ 21-22.

On July 1, 2002, JRH filed a motion to dismiss the petition. JA 30-32. Noting that Adell's claim against JRH cited in the petition was also the basis for Adell's state court civil complaint against JRH and Shekerjian, and that JRH and Shekerjian had recently filed pleadings denying all of Adell's claims, JRH argued that Adell's claim was the subject of a "bona fide dispute," precluding its use as the basis for the petition. JA 30. JRH also argued that Adell was required to have at least three petitioning creditors because JRH was an entity with 12 or more creditors. JA 31. Should the petition be dismissed, JRH asked the bankruptcy court to award it fees, costs and damages pursuant to 11 U.S.C. § 303(i). JA 31. On July 12, 2002, Adell's bankruptcy attorneys filed a notice that three additional creditors had joined in the filing of the petition. JA 33.

Appendix A

On July 15, 2002, the bankruptcy court held a hearing on JRH's motion to dismiss. Ruling from the bench, the court granted the motion, concluding that Adell was not qualified to serve as a creditor in an involuntary bankruptcy because his claim against JRH was not undisputed. The court explained:

> The record that is before the Court overwhelmingly establishes that there is a bona fide dispute concerning this petitioning creditor's claim against the Alleged Debtor ... [and]
>
> ... that there are significant genuine issues of material fact concerning any disposition of the issues raised in the [state court case], ... such fundamental issues as which of the parties breached the contract, which of the parties was the first to breach the contract. There are clear issues of fact concerning particularly the fraud claim and the statutory claim.

JA 71-72. Having rejected the sole petitioning creditor, Adell, the bankruptcy court ruled that it could not permit the joinder of other putative creditors. JA 74. Adell did not appeal the bankruptcy court's dismissal of the petition.

After a period of discovery, followed by a two-day evidentiary hearing, the bankruptcy court granted JRH's motion on April 25, 2003.[1] In a thorough opinion, the court found that Adell filed the involuntary bankruptcy petition

1. The bankruptcy court imposed a strict four-hour time limit on each side (including both direct and cross-examination).

against JRH in bad faith and awarded JRH compensatory damages in the amount of $4,100,000, punitive damages in the amount of $2,000,000, and attorneys' fees and costs in the amount of $313,230.68. JA 195-218.

Adell appealed to the district court. On August 5, 2004, in another thorough opinion, the district court ratified the bankruptcy court decision. JA 296- 330. Adell then filed the present appeal.

II. DISCUSSION

A. Legal Standards

Section 303(i) of the Bankruptcy Code provides:

> If the court dismisses a petition under this section other than on consent of all petitioners and the debtor, and if the debtor does not waive the right to judgment under this subsection, the court may grant judgment—
>
> (1) against the petitioners and in favor of the debtor for—
>
> (A) costs; or
>
> (B) a reasonable attorney's fee; or
>
> (2) against any petitioner that filed the petition in bad faith, for—

(A) any damages proximately caused by such filing; or

(B) punitive damages.

11 U.S.C. § 303(i). Applying this provision, the bankruptcy court in the present case determined that Adell filed his involuntary bankruptcy petition against JRH in bad faith and awarded JRH costs, fees, and damages. On appeal, Adell challenges all aspects of the bankruptcy court's decision: (1) its finding that he filed the involuntary bankruptcy petition in bad faith; (2) its award of $4.1 million in compensatory damages; (3) its award of $2 million in punitive damages; and (4) its award of costs and attorneys' fees.

We review the bankruptcy court's findings of fact for clear error and any conclusions of law *de novo. In re Baker & Getty Fin. Servs., Inc.,* 106 F.3d 1255, 1259 (6th Cir.1997). We evaluate the bankruptcy court decision directly, without being bound by the district court's determinations, and conduct an independent examination of the record. *In re Charfoos,* 979 F.2d 390, 392 (6th Cir.1992). "We will not disturb the bankruptcy court's findings of fact unless there is the "most cogent evidence of mistake of justice." *In re Baker,* 106 F.3d at 1259."

B. Bad Faith

Adell seeks to reverse the bankruptcy court's finding that he filed the involuntary petition against JRH in bad faith. A bankruptcy court's determination that an involuntary petition was filed in bad faith is a question of fact which will be

reversed only if clearly erroneous. *See In re Washtenaw/ Huron Inv. Corp. No. 8,* 160 B.R. 74, 79 (E.D.Mich.1993); *In re Landmark Distribs., Inc.,* 189 B.R. 290, 309 (Bankr.D.N.J.1995).

As the bankruptcy court in the present case recognized, "[t]here is a presumption of good faith in favor of the petitioning creditor, and thus the alleged debtor has the burden of proving bad faith." *In re John Richard Homes Building Co.* ("Bankruptcy Op."), 291 B.R. 727, 729-30 (Bankr.E.D.Mich.2003) (internal quotations omitted). Although this Court has never directly addressed the standard for determining bad faith under § 303(i), the bankruptcy court and the district court both concluded, and we agree, that determining whether an involuntary bankruptcy petition was filed in bad faith requires the bankruptcy court to look at the "totality of circumstances." *Id.; see also In re Cadillac by DeLorean & DeLorean Cadillac, Inc.,* 265 B.R. 574, 582 (Bankr.N.D.Ohio 2001) (applying totality of circumstances test to assess bad faith under section 303(i)) (citing *In re Caldwell,* 851 F.2d 852, 858 (6th Cir.1988) (applying totality of circumstances test to different provision of the Bankruptcy Code); *In re Zick,* 931 F.2d 1124, 1127-28 (6th Cir.1991) (same); *In re Okoreeh-Baah,* 836 F.2d 1030, 1033 (6th Cir.1988) (same)).[2]

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2. In looking at the totality of the circumstances, there are various definitions of bad faith that a court might consider:

> (1) an "improper use" test under which bad faith is found based on creditor attempts to obtain disproportionate advantage by means of an involuntary filing; (2) an "improper purpose" test under which bad faith is found

(Cont'd)

Appendix A

1. Evidence

In order to prove Adell's bad faith, JRH introduced testimony and other evidence that:

• Even though JRH quickly resolved Adell's first complaint about the pace of construction—that the "dewatering" of Adell's site had temporarily ceased-by obtaining the permits needed to "dewater" through the night, Adell's very next action was to tell Shekerjian that he wanted someone else to build his home. Appendix ¶ 5.

• Shortly after the dewatering episode, Adell told Shekerjian about a prior dispute Adell had had over a building permit and how Adell had retaliated against the village with whom he had the dispute, implying to Shekerjian that Adell was the type of person who was likely to respond very aggressively to anyone who didn't do what he wanted. *Id.* ¶ 6.

• On May 31, 2002, before any serious discussion had occurred between Adell and JRH about Adell's complaints, Adell's attorney threatened Shekerjian with criminal prosecution if JRH didn't meet Adell's demands. *Id.* ¶ 10.

(Cont'd)

> when an involuntary filing is made based on ill-will, malice, or a desire to embarrass or harass the alleged debtor; and (3) a bad faith inquiry based on the standards set forth in Bankruptcy Rule 9011.

In re Cadillac, 265 B.R. at 583.

• JRH first learned that Adell thought he had paid too much for the property on June 3, 2002. On several occasions thereafter, before the petition was filed, JRH or its representatives advised Adell or his representatives that it was JRH's position that the land had been properly valued at the closing and that an independent investigation by Adell or his attorneys of land values in Bloomfield Hills would confirm that fact. *Id.* ¶ 11, 13(b).

• As soon as Shekerjian learned that Adell thought the land was only worth $1,000,000, he offered to buy the property back. Adell refused the offer, yet then threatened to file an involuntary bankruptcy petition against JRH. *Id.* ¶ 12.

• At the June 3 meeting and on several occasions thereafter, JRH's representatives informed Adell that it was JRH's position that filing an involuntary bankruptcy petition would be improper. *Id.* ¶ ¶ 12, 13(a), 17, 19.

• On several occasions before the petition was filed, JRH's representatives informed Adell or his representatives that JRH disputed Adell's claim that the construction pace was too slow and that JRH considered Adell to be the one in breach of the construction agreement. *Id.* ¶ ¶ 13(b), 18.

• Adell ignored JRH's attempts to settle the matter before litigation. *Id.* ¶ ¶ 13(c), 14.

• While Adell's state court suit against JRH was pending, he contacted several JRH contractors trying (unsuccessfully) to get them to join him in filing an involuntary bankruptcy petition. *Id.* ¶ ¶ 15, 16.

• Adell knew at the time he filed the petition that it was critical that he have an undisputed claim of over $12,000 against JRH. *Id.* ¶ 2.

• Adell's bankruptcy attorneys filed the petition without obtaining several documents (of which Adell was or should have been aware) that would have alerted them to the fact that JRH disputed all of Adell's claims. *Id.*

• Adell sought to publicize the filing of the involuntary bankruptcy petition and to spread misinformation about JRH. For example, at his behest, his public relations firm misrepresented to various media publications that JRH had at least nine dissatisfied customers, when, in fact, at least two of the nine, Jean McIntyre and Larry Gainer, definitely had no problems with JRH; there is no showing that any of the other seven did either. *Id.* ¶ ¶ 22, 23.

Adell responded with testimony and evidence that:

• Prior to filing the petition, he had learned from two former JRH employees, Debra Lee Bjorkly and William Seklar, that JRH was in dire financial straits. *Id.* ¶ ¶ 7,8.

• Prior to filing the petition, he had also learned from Bjorkly and Seklar that Shekerjian was aware of the water problem on his property when he sold the land to Adell and knew that building on it would be problematic. *Id.* ¶ ¶ 7,8.

• He believed when he filed the petition that he had an undisputed claim of at least $133,000, the amount out of the total paid by Adell that he believed had been allocated for home construction. JA 911.

• At the time the petition was filed, he was unaware that JRH and Shekerjian had filed an answer and other responses to his civil complaint denying all of his claims. JA 927.

• Prior to filing the petition, Shekerjian had admitted that he owed Adell money, but that he did not have the money to refund to him. JA 921-22.

• He was not motivated by malice or by a desire to put JRH out of business. JA 917.

• He did not seek to publicize the bankruptcy. JA 918.

• He did not threaten other creditors in order to persuade them to join the petition. JA 920.

On rebuttal, JRH offered testimony and evidence that:

• JRH was not in financial difficulty. JA 974-75.

• Bjorkly and Seklar, the only two former JRH employees who testified for Adell, had personal grievances against JRH and Shekerjian and their testimony was not credible. JA 972-979.

• Bjorkly and Seklar are the only two former employees Shekerjian has ever litigated against. JA 978.

2. Bankruptcy Court's Decision

The bankruptcy court concluded that Adell filed the petition in bad faith, finding the evidence of bad faith "overwhelming." Bankruptcy Op., 291 B.R. at 731. It explained:

> The totality of the circumstances compels the conclusion that Adell did not honestly believe that the involuntary bankruptcy petition would be appropriate. Adell did not file this petition in a sincere and honest belief that he was entitled to bankruptcy relief against JRH. Rather, he proceeded with the wrongful intent to intimidate Shekerjian into a settlement and, when that failed, to damage or destroy his business.

Id. at 735.

3. Analysis

The bankruptcy court made seven specific findings in support of its ultimate finding of bad faith. *Id.* at 731-35. Adell first attempts to show that the bankruptcy court's ultimate finding of bad faith was clearly erroneous by challenging each of these underlying findings—either as clearly erroneous or immaterial or both; in the alternative, he argues that there is evidence of good faith that outweighs any evidence of bad faith. We will address each argument in turn.

Appendix A

a. Finding that Adell knew or should have known that his claim was disputed

The bankruptcy court found that "on July 15, 2002, when Adell filed this involuntary bankruptcy petition, he knew or should have known that his claims were the subject of a bona fide dispute" because "[b]y then, JRH had responded to Adell's state court complaint by filing substantial defenses, affirmative defenses and counterclaims." *Id.* at 731. Adell challenges this finding by citing his own testimony to the contrary, JA 909-17, and by arguing that Shekerjian conceded that at least $133,000 of the money Adell had paid was for construction costs and, therefore, should have been held in trust for him, JA 676-69.

While it is true that Adell testified that he did not know his claim was disputed, the bankruptcy court found that testimony not credible or, even if true, the result of unjustifiable ignorance. Bankruptcy Op., 291 B.R. at 731-32. As explained by the bankruptcy court:

> Adell testified that he was not aware of these responsive pleadings until after the involuntary bankruptcy petition was filed. There are four problems with this position:
>
> First, his state court attorneys were aware of these pleadings before the petition was filed. His attorneys' failure to advise him of them in a timely way can be of no help to him.

> Second, the nature of Adell's claims was such that he would certainly not require legal advice to understand that he and JRH would have real and substantial legal and factual disputes, and further that the litigation to resolve these disputes would be lengthy and costly. Even before JRH filed responsive pleadings, Adell could not have reasonably concluded that JRH would simply admit that it had committed the frauds and the other intentional wrongs that he had alleged.
>
> Third, the evidence establishes that even if Adell was not aware of JRH's responsive pleadings, he already knew that his state court claims would be contested. At least twice before Adell filed the involuntary petition, JRH's attorneys specifically told Adell's attorneys that JRH would contest Adell's claims and that therefore an involuntary petition would be improper....
>
> Fourth, Adell took no action to withdraw the involuntary petition when he did become aware of JRH's state court responses.

Id. (internal citations omitted). As Adell makes no attempt to challenge the probative value of the evidence cited by the bankruptcy court or to challenge the bankruptcy court's use of that evidence in support of its finding, and especially in light of the special deference given to a trial judge's credibility findings, we cannot conclude that the bankruptcy court clearly erred in rejecting Adell's testimony.

Adell's second argument is that there was no bona fide dispute with respect to at least $133,000 and, therefore, no basis for finding that Adell knew or should have known that his claim was subject to a bona fide dispute. There are numerous problems with this argument. First, even if Shekerjian conceded he was holding at least $133,000 in trust for Adell, he never conceded that Adell's claim to that money was undisputed. Second, the question whether Adell's claim was subject to a bona fide dispute was resolved by the bankruptcy court's decision in July 2002 dismissing the petition, a decision which Adell did not appeal. Thus, Adell cannot now argue that, in fact, there was a bona fide dispute. Finally, while it is certainly possible that a creditor could reasonably but erroneously believe there was no bona fide dispute, Adell is not that creditor. As the district court concluded, Adell's alleged good faith belief that the $133,000 was undisputed was clearly "manufactured after the fact," as shown by the fact that it was never mentioned by his attorneys during the motion to dismiss hearing.

As neither of Adell's two challenges to the bankruptcy court's first finding have merit, we conclude that it did not clearly err in finding that Adell knew or should have known at the time he filed the petition that his claim was subject to a bona fide dispute.

b. Finding that Adell knew the petition would harm JRH and intended that harm

The bankruptcy court found that "Adell knew of the serious harm that JRH would suffer as a direct consequence of the involuntary filing" and that "Adell intended to cause

that harm." *Id.* at 732. Adell first argues that this finding is immaterial to the issue of bad faith as long as Adell reasonably believed that JRH belonged in bankruptcy. He also disputes the finding itself by citing his own testimony that he never threatened to commence a bankruptcy, JA 917, and that he did not hire his public relations firm, Marx Layne, for the purpose of publicizing the bankruptcy, JA 918.

As discussed above, the bankruptcy court found, and we have upheld its finding, that Adell knew or should have known that his claim against JRH was the subject of a bona fide dispute. It necessarily follows that Adell knew or should have known that JRH did not belong in bankruptcy. Accordingly, his claim on appeal that he reasonably believed JRH belonged in bankruptcy is plainly without merit.

Adell testified that he never threatened JRH with bankruptcy and that he did not hire Marx Layne to publicize the bankruptcy but rather to defend against inquiries about the civil case. JA 918. However, the bankruptcy court heard his testimony and found it not credible on both points. Bankruptcy Op., 291 B.R. at 732-33. The bankruptcy court's explanation of why it found Adell's testimony not credible on these two points is extensive and supported by substantial evidence that Adell does not address. *Id.* at 732. Accordingly, we see no error in the bankruptcy court's rejection of Adell's testimony on these two points and, accordingly, no basis for disturbing its finding that Adell knew the filing would cause JRH harm and intended that harm.

c. Finding that Adell's attorney threatened Shekerjian with criminal prosecution

The bankruptcy court found that Adell's attorney in his civil matter, Dennis Dlugokinski, had on several occasions "outrageously threaten[ed] *criminal prosecution* " unless Shekerjian agreed to remove any mortgages and liens on the property, to cancel any debt owing by Adell, and to make restitution and pay damages. *Id.* at 733. On appeal, Adell does not challenge the accuracy of this finding, but he argues that it is immaterial to the question of whether Adell reasonably believed he could file the involuntary petition. We disagree. Given that the standard for judging bad faith is the "totality of the circumstances," the fact that Adell was issuing such threats in a civil suit involving the same issues is certainly a fact that the bankruptcy court may properly consider.

d. Finding that Adell was unable to explain how he calculated the $800,000 figure in the involuntary bankruptcy petition

The bankruptcy court found that "Adell was unable to articulate" how the $800,000 figure in the involuntary bankruptcy petition was calculated. *Id.* On appeal, Adell challenges this finding by citing his own testimony that he arrived at the $800,000 figure by subtracting the value of the land, $1 million, from the total amount he had already paid, $1.8 million, JA 909-17, and the testimony of Max Newman, one of his bankruptcy attorneys. JA 940. Despite Adell's trial testimony, the bankruptcy court's finding is not clearly erroneous. At Adell's deposition in August 2002, a

short time after the petition had been filed, he testified that he didn't know how he arrived at $800,000 and that he had relied on his bankruptcy attorneys to determine the amount listed in the petition. JA 929. Presumably the bankruptcy court based its finding on Adell's deposition testimony, impliedly finding it credible and Adell's trial testimony not credible. *See* 9A Charles Alan Wright & Arthur R. Miller, Federal Practice & Procedure: Civil 2d § 2579 (where a lower court has "fail[ed] to make a finding on a particular fact," the court is presumed to have "impliedly made a finding consistent with its general finding"). Absent a reason for rejecting this omnibus credibility finding, Adell's challenge to the bankruptcy court's specific finding that Adell was unable to articulate the basis for the $800,000 debt alleged in the involuntary bankruptcy petition fails.

e. Finding that Adell flaunted his wealth and threatened other creditors

The bankruptcy court found that "Adell used improper threats and flaunted his wealth in an attempt to solicit creditors to join his petition." Bankruptcy Op., 291 B.R. at 733. On appeal, Adell challenges this finding by citing his own testimony to the contrary. JA 851-55, 920.

In making its finding, the bankruptcy court relied on the testimony of two JRH creditors, Cynthia Weaver and Robert Clark. Bankruptcy Op., 291 B.R. at 733; *see also* Appendix ¶ ¶ 15, 16. The court credited their testimony and rejected Adell's testimony to the contrary. *Id.* Adell has not offered any reason, and none is apparent, why we should conclude that the bankruptcy court clearly erred by crediting the testimony of the two creditors over Adell's own self-serving testimony.

Adell also argues that even if true, this finding is "irrelevant" to the issue of bad faith. Again, the "totality of the circumstances" test renders that a difficult argument to support. We have no difficulty in concluding that the bankruptcy court correctly ruled that Adell's flaunting of his wealth and threatening other creditors is relevant to a determination as to whether the petition was filed in bad faith.

f. Finding that Adell's reliance-on-counsel defense is not persuasive

The bankruptcy court found that Adell's testimony that he filed the petition in "reliance on the advice of experienced bankruptcy attorneys ... must be rejected" because of Adell's failure to fully disclose all relevant information to his bankruptcy counsel, Newman. *Id.* As explained by the bankruptcy court, Adell and his other attorneys

> "withheld from Newman significant information that plainly would have, or should have, made a difference on the critical issue of whether JRH either "admitted," or at least did not dispute, any portion of Adell's claim."

Id.

Adell does not dispute the legal rule, articulated by the bankruptcy court, that "a client reasonably relies on an attorney's advice only when the client provides to the attorney all of the pertinent facts in the client's possession." *Id.* at 734-35 (internal quotations omitted). Nor does he challenge the bankruptcy court's conclusion that he failed to disclose

certain information to his bankruptcy attorneys.[3] He does contend that he fully disclosed all the *relevant* facts and, therefore, that his reliance-on-counsel defense should not have been rejected. We disagree. Adell's bankruptcy attorney testified that in filing the petition he had relied on Adell's (and his attorney's) representation that there was an undisputed claim over $12,000, and that he was unaware of several key documents, which he would like to have seen. JA 940, 945. Under those circumstances, a reliance-on-counsel defense is not viable. As the bankruptcy court explained:

> Newman's advice that an involuntary petition would be proper was based on Adell's assurance that JRH would admit a claim of at least $12,000. However, as found above, Adell knew that JRH would vigorously dispute his claim and therefore that this assurance was false. Moreover, Newman certainly would have determined that the assurance was false if only Adell had not withheld

3. The bankruptcy court found that there were three material items that neither Adell nor his attorneys provided to Newman: (1) a June 5, 2002 letter from one of JRH's attorneys, E. Michael Morris, to Dlugokinski, "in which Morris clearly took the position that Adell had explicitly agreed to the purchase price of $1,750,000 for the real property and that it was Adell, not JRH, that was in breach of the construction contract"; (2) another June 5, 2002 letter from Morris to Dlugokinski "in which Morris demanded that Adell cease disparaging JRH and cease soliciting creditors for an involuntary bankruptcy petition" and threatened "severe sanctions for damages in the event it files a frivolous petition for bankruptcy"; and (3) "most inexplicably of all ... a copy of JRH's answer to Adell's state court complaint or JRH's counterclaim." *Id.*

> pertinent facts and documents. Accordingly, Adell's defense of reliance on counsel must be rejected.

Id. at 735. We also agree with the bankruptcy court that "Adell's conduct in deliberately withholding evidence from his bankruptcy counsel is further evidence of his bad faith in causing the involuntary petition to be filed." *Id.*

g. Finding that Adell did not file out of concern for other creditors

The bankruptcy court found that "Adell falsely testified that in filing the involuntary petition, he was motivated by a concern for JRH's trade creditors," explaining that "[i]f he were indeed so charitably motivated, he would not have threatened at least two creditors that the only way they would be paid would be to join in the petition." *Id.* Adell first challenges the finding that he threatened at least two creditors by citing his own, Mark Layne's (the head of the public relations firm, Marx Layne) and Bjorkly's testimony to the contrary. *See* JA 562, 853-54, 896. Here again, Adell fails to offer any basis for rejecting as clearly erroneous the bankruptcy court's decision to credit the testimony of Weaver and Clark, *see* Appendix ¶ ¶ 15, 16, over the testimony of Adell, Bjorkly and Layne.

Adell also argues that even if he did say it, it was not a threat but simply the truth, and, therefore, irrelevant to the question of bad faith. As discussed above, however, a bankruptcy court looking at the totality of the circumstances in order to decide whether an involuntary bankruptcy petition

has been filed in bad faith is entitled to consider the fact that the petitioning creditor apparently (or at least arguably) was making threats to other creditors prior to filing the petition.

h. Evidence of Good Faith

Adell argues that even if none of the bankruptcy court's findings that underlie its ultimate finding of bad faith were clearly erroneous, it erred by failing to give due consideration to the evidence in the record of Adell's good faith. He argues that if the evidence of his good faith had been properly considered, it would have outweighed the evidence of bad faith.

Adell points to the following evidence in the record as evidence of his good faith:

• Bjorkly's testimony that she told Adell that JRH was not paying its trade creditors and that other customers were having liens placed on their homes, that she told Adell that everyone at JRH knew there was a serious water issue, and that she told Adell that Shekerjian had told her he was going to "screw" Adell on the cabinet prices, JA 887-893.

• Adell and his bankruptcy counsel's testimony that counsel had told Adell that Adell's money had been transferred to another entity and was probably being dissipated, JA 913, 938.

• Adell's counsel's testimony that he told Adell that JRH was probably insolvent, JA 938.

• Adell's testimony that Shekerjian admitted owing him money and told him he couldn't give him a refund or start building, JA 912-13, 921-22, that no progress was being made on the home, JA 923, 965, and that his bankruptcy counsel advised him to file the petition and that he relied on their advice in signing it, JA 914-15.

• The testimony of Adell, Layne and Bjorkly that Adell was filing out of concern for other creditors, JA 562, 853-54, 896.

As explained above, the bankruptcy court found, and we see no basis for disturbing those findings, that much of the testimony cited by Adell as evidence of good faith was not credible. Even without that problem, in weighing the purported evidence of good faith identified by Adell against the "overwhelming" evidence of bad faith relied on by the bankruptcy court, we conclude that the finding that Adell filed the petition in bad faith was not clearly erroneous.

C. Amount of Compensatory Damages

Having found no error in the bankruptcy court's determination that Adell filed the petition against JRH in bad faith, we turn to Adell's challenges to the compensatory damages award. Under 11 U.S.C. § 303(i) a bankruptcy court has the discretion to award compensatory damages for the injuries proximately caused by the bad faith filing of an involuntary bankruptcy petition. Here, the bankruptcy court found that the negative publicity surrounding the filing damaged JRH's future business. Bankruptcy Op., 291 B.R. at 735. It then determined that JRH's lost future profits,

"calculable with a reasonable degree of certainty," totaled $4,100,000, based on an estimated loss of 20 home sales over the next five years (a 50% decline in sales) at an average sales price of $1.9 million and an incremental profit margin of 17%. *Id.* at 735-36. On appeal, Adell challenges both the bankruptcy court's proximate cause finding and the amount of its damages award. We review for clear error.

1. Proximate Cause ("Fact" of Damage)

Under section 303(i) of the Bankruptcy Code, the alleged debtor may recover damages "proximately caused" by the bad faith filing of an involuntary bankruptcy petition. Adell contends that the bankruptcy court "assumed" that the filing would be the proximate cause of future lost profits, but that there is not enough evidence in the record to justify that assumption. He emphasizes that JRH failed to offer expert witness testimony on the effects of negative publicity and, citing *In re Cadillac by DeLorean,* 265 B.R. 574, 584 (Bankr.N.D.Ohio 2001), that lost profits "must be proven through more than general testimony about reaction within the community." We review these factual findings for clear error. *Huss v. King Co., Inc.,* 338 F.3d 647, 652 (6th Cir.2003).

The record is not as barren as Adell suggests. Shekerjian testified that JRH was "totally devastated" by the petition and that shortly after the petition was filed JRH lost two high-end contracts. JA 627, 630, 632, 665. He also testified that in the six months between when the petition was filed and the bankruptcy court hearing JRH did not sell a single home. JA 627. Finally, he testified that a builder's reputation

was "absolutely critical" to selling homes in the high-end market. JA 632. Considering this testimony, the bankruptcy court found that "Shekerjian credibly testified that the ability of JRH to compete in the market for high end homes is critically affected by its reputation." Bankruptcy Op., 291 B.R. at 735.

In addition, David Johnson, a local real estate developer in the high-end market, testified that the petition greatly affected JRH's ability to sell homes in that market. JA 510-11. In the six months after the filing, he testified, JRH's financial stability was a recurring topic of discussion at the various events Johnson sponsored. JA 511. In addition, while during that period there were housing starts in his development by other builders, there were none by JRH. JA 511. As he explained it, "[t]he most important thing in the cosmic value and super-lux marketplace, and what has been the foundation of my reputation, is integrity, reliability and predictability." JA 510.

The foregoing considered, JRH was under no obligation to present an expert on this issue. Accordingly, we reject Adell's contention that the bankruptcy court clearly erred in finding that the record evidence establishes that the filing was the proximate cause of damage to JRH.

2. Amount of Damages

Adell also challenges the amount of compensatory damages awarded. In finding that JRH was "entitled to an award of compensatory damages in the amount of $4,100,000," the bankruptcy court credited the testimony of JRH's expert, Frazee, explaining:

Appendix A

> The Court finds that Frazee's calculation of lost profits and the assumptions on which that calculation is based are entirely reasonable. Frazee testified with credibility. His expertise and methodology were not undermined in any substantial way. His assumptions were supported by other credible evidence. His calculation of JRH's damages is to a reasonable degree of certainty in the circumstances. Any lingering uncertainty about the calculation of lost profits is a result of Adell's own conduct in filing the improper bankruptcy petition and thus must not be permitted to prejudice JRH.

Bankruptcy Op., 291 B.R. at 736. On appeal, Adell contends that the bankruptcy court erred by (1) accepting the expert's use of the past profits of other Shekerjian entities that had operated in the high-end market (the "Affiliates") as a reasonable basis for estimating JRH's expected future profits; (2) accepting the expert's representation that the Affiliates had a historical profit margin of 17% even though there was no evidence in the record to support that figure; (3) accepting the expert's assumption that absent the filing of the petition JRH's sales would have continued at the same rate in the future; and (4) accepting the expert's assumption that JRH would lose precisely four (4) sales per year for a five-year period. Once the fact of damage is established, the amount of damage need only be proved to a reasonable degree of certainty, and our review of this factual determination is for clear error.

Appendix A

a. Expert's Use of the Affiliates' Past Business as Basis for Calculating JRH's Estimated Future Lost Profits

In order to estimate JRH's future lost profits, and because JRH itself had only been created in January 2001, JRH's expert relied in part on the past business records of the Affiliates. On appeal, Adell argues that by accepting the expert's use of the past business of the Affiliates to calculate JRH's future lost profits, the bankruptcy court effectively (and illegitimately) allowed JRH to be compensated for the Affiliates' lost future profits. While only JRH's future lost profits are compensable, that does not necessarily mean that the past business of the Affiliates is irrelevant.

In the present case, Shekerjian testified that JRH was created in early 2001 in order to consolidate in one entity the high-end home building business that had previously been handled by the Affiliates. JA 623. He also testified that as part of the formation of JRH, he had phased out a number of the Affiliates, and others were set to be phased out as soon as their ongoing projects were completed. JA 624. Thus, he opined, Frazee's use of historical sales data from the Affiliates was a "reasonable" predictor of JRH's potential future earnings because the business of those entities was "being funneled into [JRH] going forward." JA 634-35. Frazee testified that given JRH's recent creation, the best evidence of its future profits was the past profits of the Affiliates, whose business it was taking over. JA 610. This record evidence supports the bankruptcy court's decision to accept the use of the past business of the Affiliates as a basis for estimating JRH's lost future profits. Adell's charge of clear error on this ground thus fails.

b. Record Evidence of Affiliates' Past Profits

In estimating JRH's future lost profits, Frazee testified that he used a 17% profit margin because that was the historic profit margin of the Affiliates for high-end homes constructed in the past five years. JA 576-79. Frazee testified that he calculated the 17% figure by reviewing a number of documents provided to him by JRH. On appeal, Adell argues the bankruptcy court should not have accepted that testimony absent actual evidence in the record of the Affiliates' past profits.

While expert testimony may not be used to establish underlying facts not otherwise in evidence, *see In re James Wilson Assocs.*, 965 F.2d 160, 172 (7th Cir.1992), that is not what happened here. Rather, JRH's expert utilized the past profits of the Affiliates to estimate JRH's future lost profits and then testified accordingly. The bankrtuptcy court relied on the testimony of JRH's expert in calculating JRH's damages, which JRH bore the burden of proving to a reasonable degree of certainty. Had JRH had an independent need to prove the past profits of the Affiliates, the present record might be inadequate. However, it did not. Indeed, Federal Rule of Evidence 705 expressly contemplates that an expert may offer an opinion without the record containing all of the underlying facts on which that opinion is based:

> The expert may testify in terms of opinion or inference and give reasons therefore without first testifying to the underlying facts or data, unless the court requires otherwise. The expert may in any event be required to disclose the underlying facts or data on cross-examination.

Fed.R.Evid. 705. Thus, an opposing party who would challenge the facts underlying the expert's opinion must do so by cross-examination. *See Int'l Adhesive Coating Co., Inc. v. Bolton Emerson Int'l, Inc.*, 851 F.2d 540, 544-45 (1st Cir.1988); *see also Smith v. Ford Motor Co.*, 626 F.2d 784, 793 (10th Cir.1980) (holding that the effect of Rules 703 and 705 is to "place the full burden of exploration of the facts and assumptions underlying the testimony of an expert witness squarely on the shoulders of opposing counsel's cross-examination").

c. Record Evidence to Support Assumption of Continued Sales at the Same Rate for the Next Five Years

In estimating JRH's future lost profits, Frazee assumed that, absent the petition, sales would have continued at the same rate for the next five years. On appeal, Adell contends that the record does not support this assumption. In support, he cites the testimony of Bjorkly and Seklar, both of whom testified that JRH and/or the Affiliates' sales were decreasing before the filing of the petition. Adell also asserts that JRH should have proffered an expert on market conditions in order to justify this assumption. His contention is not persuasive. First, the bankruptcy court impliedly found the testimony of Bjorkly and Seklar not credible; a finding that is justified given Shekerjian's testimony that JRH's sales had not been declining. *See* JA 977. Second, although JRH did not have an expert on market conditions, both Shekerjian and Johnson testified that the market for luxury homes had not been affected by the general market downturn. *See* JA 512, 626-27, 641. This record evidence is more than adequate to

support a conclusion that the decision of the bankruptcy court to accept the expert's assumption of continued sales at the same rate was not clearly erroneous.

d. Evidence Supporting Assumption of Loss of Four Sales Per Year for Five Years

Finally, Adell contends that there is no evidence supporting JRH's expert's assumption that JRH would lose four sales per year (50%) for the next five years, but that is simply not true. Frazee's assumption is supported by Shekerjian's testimony that he thought a 50% reduction over five years was reasonable and, if anything, conservative, given the nature of the high-end home business. JA 636-37. Specifically, Shekerjian testified that Frazee's assumption that JRH would lose four home sales per year for the next five years due to the filing of the petition was "extremely conservative" because:

- "this is something that people won't forget," JA 636;

- Frazee excluded several very expensive homes from his calculation of the total number of homes sold over the previous five years, JA 637;

- JRH had sold zero homes since the bankruptcy filing, although 50 permits for high-end homes in the relevant area had been issued during that six-month period, JA 637, 641;

- high-end sales are primarily driven by the "ripple effect"—that is, sales lead to people talking, leading to more sales; any negative publicity is potentially devastating and with respect to JRH the "buzz in the marketplace [wa]s ... quite prominent," JA 637, 639;

• Shekerjian's plan for JRH in the future, as evidenced by JRH's heavy investment in land in the Turtle Lake development (over $4 million), had been to double the number of high-end homes sold per year, JA 638.

In addition, as described above, Johnson testified, based on his personal observations of the market, that JRH's ability to sell homes had been negatively affected by the petition. JA 508-512. More generally, estimating future lost profits is necessarily imprecise. Here the record adequately supports the assumption that JRH would lose four home sales per year for five years following the filing of the petition. Even if that assumption turned out to be wrong, the damages award might still be conservative because, as Shekerjian testified, it does not include the money JRH had spent and would continue to spend to try to repair its reputation and its banking and accounting relationships, JA 637-38, and it does not include the money JRH had invested in land hoping to increase the number of high-end homes it built in the future, JA 638-39.

D. Punitive Damages

Adell seeks to overturn the bankruptcy court's $2,000,000 punitive damages award. He challenges the award on both constitutional and non-constitutional grounds. We apply *de novo* review to the constitutional challenge, but otherwise review only for abuse of discretion. *See Cooper Indus., Inc. v. Leatherman Tool Group, Inc.*, 532 U.S. 424, 433, 436, 121 S.Ct. 1678, 149 L.Ed.2d 674 (2001); *Smoot v. United Transp. Union*, 246 F.3d 633, 647-48 (6th Cir.2001). "A district court abuses its discretion when it relies on clearly

erroneous findings of fact, or when it improperly applies the law or uses an erroneous legal standard." *Id.* (quoting *Owner-Operator Indep. Drivers Ass'n v. Bissell,* 210 F.3d 595, 597 (6th Cir.2000)).

In order to comply with due process, the Supreme Court has directed a court awarding punitive damages to consider three factors:

> (1) the degree of reprehensibility of the defendant's misconduct; (2) the disparity between the actual or potential harm suffered by the plaintiff and the punitive damages award; and (3) the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases.

State Farm Mut. Auto. Ins. Co. v. Campbell, 538 U.S. 408, 123 S.Ct. 1513, 1520-21, 155 L.Ed.2d 585 (2003). The bankruptcy court in the present case expressly addressed each of these factors in explaining how it arrived at the $2,000,000 punitive damage award, finding that "Adell's conduct was reprehensible and must be deterred and punished," that "within the permissible ratio that the Supreme Court has suggested, punitive damages might be assessed up to about $41,000,000," and that comparable penalties permitted fines of twice the victim's loss. Bankruptcy Op., 291 B.R. at 739 (internal citations omitted). The court concluded that:

> [P]unitive damages of $2,000,000 are necessary and appropriate in this case. Such a punishment is approximately one-half of the compensatory

> damages of $4,100,000. It is approximately one twentieth of the maximum limit that Supreme Court suggests for due process purposes, here $41,000,000. It is approximately one fourth of the maximum fine for the most analogous federal crime, here $8,200,000. In the Court's judgment, this is the minimum punitive damage amount that will address the dual purposes of adequate deterrence and punishment.

Id. at 739.

On appeal, Adell faults the bankruptcy court's analysis for (1) failing to consider mitigating evidence; (2) failing to consider the size of other awards pursuant to section 303(i); (3) concluding that his conduct was reprehensible; (4) if the compensatory damages award is reduced, understating the ratio of punitive damages to compensatory damages; and (5) failing to consider the civil or criminal penalties for comparable misconduct. None of his arguments have merit. Having found no error in the bankruptcy court's finding that the petition was filed in bad faith, or in its credibility judgments, its conclusion that Adell's conduct was reprehensible and that Adell presented no credible mitigating circumstances is amply supported by the record. Having upheld the bankruptcy court's compensatory damage award, it follows that its analysis of the ratio of punitive damages to compensatory damages is accurate. And, finally, Adell's charge that the bankruptcy court failed to consider the civil or criminal penalties for comparable misconduct is simply false. *See id.*

The only issue raised by Adell that merits any further discussion is whether the bankruptcy court erred by not considering the size of other punitive damages awards pursuant to section 303(i). We think not. While the size of other punitive damage awards under section 303(i) is arguably relevant, the Supreme Court's three-part framework for analyzing punitive damage awards does not require courts to make that comparison. Nor are we persuaded that the bankruptcy court here should have made that comparison simply because its award was, according to Adell, the "biggest" ever. Where, as here, a bankruptcy court follows the applicable law and thoroughly and persuasively explains the basis for its punitive damages award, there is no basis for concluding that the size of the award was an abuse of discretion.

E. Fees and Costs

The bankruptcy court awarded JRH attorneys' fees and costs. *Id.* at 740. On appeal, Adell argues that the bankruptcy court should not have awarded them because (1) he filed the petition in good faith and (2) the claim was not subject to a bona fide dispute. Neither argument has merit. As discussed above, this Court has found no error in the bankruptcy court's bad faith ruling. Accordingly, Adell's challenge to the award of fees and costs based upon his claimed good faith must fail. As for Adell's contention that his claim against JRH was not subject to a bona fide dispute, that issue was decided against Adell when the bankruptcy court dismissed the petition, and Adell did not appeal that ruling.

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III. CONCLUSION

For the reasons stated in the foregoing opinion, the district court's decision affirming the bankruptcy court's award of compensatory and punitive damages, attorneys' fees, and costs is AFFIRMED.

APPENDIX

CHRONOLOGY (December 2001-July 2002)

December 2001

1. On December 28, 2001, Adell and JRH entered into a Residential Building and Purchase Agreement ("Agreement"), providing that in exchange for $3,030,000, JRH would sell Adell a 1.8 acre parcel of land in Bloomfield Hills, Michigan, and construct a home for Adell there. JA 779-787.

2. Although JRH's cost in the land was in excess of $1.7 million, the Agreement did not specify how the $3,030,000 would be allocated between the land purchase and the home construction. JA 648.

3. The Agreement required JRH to commence construction "within a reasonable time after this Agreement is signed and plans are completed and [a] permit is issued." JA 780.

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4. On February 28, 2002, the sale closed. JA 646. According to the "Warranty Deed" and the "Settlement Statement," both of which were signed at the closing, $1,750,000 out of the $3,030,000 was for the land purchase, leaving $1,280,000 for the home construction. JA 717-18, 792.

March-April 2002

5. Adell called Shekerjian to complain that the "dewatering" of his site had ceased. JA 653. Shekerjian explained to Adell that JRH had temporarily stopped dewatering until it obtained a permit from the City to continue through the night because otherwise the dewatering would be pointless. JA 653. Within a few days JRH had obtained the necessary permit. JA 653-54. However, at that point, Adell told Shekerjian that he wanted someone else to build his home, specifically his brother-in-law. JA 653, 654.

6. Around this same time, Adell told Shekerjian about a permitting dispute he had previously had with another town. He told Shekerjian that in retaliation for the "hard time" the town gave him, he built "the ugliest home he could possibly think of just to piss them off." JA 658-661.

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7. Adell's representative and then Adell himself contacted Debra Lee Bjorkly, a former JRH employee (from August 2000 until April 2002). JA 885. Adell had met Bjorkly

twice before in the course of his dealings with JRH. JA 882, 883. When Adell's representative told Bjorkly that Adell had just learned about the water on the property, she told him that "everybody knew there was water on the property." JA 885-87. Bjorkly later testified that Butch Friedman, the construction manager working on Adell's house, was frustrated by the amount of water on the property. JA 897-98. Bjorkly also told Adell that JRH was having financial trouble. She testified that she had told Adell that in November/December 2001 things were very tense in the office because there were a lot of trades in the reception room waiting for money, that one employee had asked to have her desk moved because she didn't want to see the trades going back and forth outside her window, that the construction manager for Adell's property was frustrated by trades not showing up because they hadn't been paid, and that her customers before she left had been "upset" because "they felt that their projects were being put on hold or being delayed, that trades were not showing up, products were not being released," JA 893-94, 897-98. Subsequently, Adell called Bjorkly and asked her if she had a list of vendors or trades who were owed money by JRH. JA 889. She gave him a verbal list over the telephone. JA 889. Eventually, JRH and Bjorkly ended up in litigation; according to Bjorkly's later testimony, JRH sued her for disclosing confidential information. JA 896.

8. Adell contacted William Seklar, an employee of one of the JRH affiliates from January 1999 until he was terminated on November 30, 2001. JA 959-60. Seklar, whose job had been the high-end marketing and sales of custom homes, JA 949, told Adell that he had been involved in the

purchase of Adell's property and had sought a variance to change the grade for Adell's property due to the water levels. JA 958-59. He also told Adell that JRH was having financial troubles. Seklar later testified that he told Adell that he had encountered difficulty performing his job for JRH starting certainly by the year 2000 because JRH was "having difficulties in completing clients' homes, difficulties in paying trades, difficulties in getting trades to respond to us to work on the client residences," and that "[t]here was[sic] liens put on customers clients' homes." JA 949-50.

9. When Shekerjian learned that Adell or his representatives were contacting JRH's contractors and former employees, he had one of his attorneys, E. Michael Morris, call Adell's attorney, Dennis Dlugokinski, and warn him that they considered such contacts to be "highly improper and actionable." JA 807.

10. Adell then had Dlugokinski send a letter to Shekerjian. In that letter, dated May 31, 2002, Dlugokinski stated that he represented Adell in connection with his claims arising out of his purchase of property from Shekerjian, that he intended to "pursue civil remedies and/or criminal investigations by and criminal remedies through the the Michigan Attorney General's Office, the Oakland County Prosecutor's Office and/or the Federal Bureau of Investigation and other federal and state agencies and departments having jurisdiction." To "resolve the matter before the institution of a lawsuit," Dlugokinski advised Shekerjian to "make[e] immediate arrangements to remove any and every mortgage and/or lien against the property," to "cancel[ ] indebtedness owing or allegedly owing by Mr.

Adell," and to "mak[e] restitution and pay [ ] appropriate damages to Mr. Adell." JA 805. Dlugokinski gave Shekerjian until 5:00 p.m. that day to respond. JA 805.

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11. Shekerjian apparently did not respond to Dlugokinski's letter, but on June 3, 2002, he and Morris met with Dlugokinski and Adell to discuss matters. JA 467-68. At that meeting, for the first time, Adell told Shekerjian that he thought he had paid too much for the property, asserting that the property was worth $1 million instead of $1.75 million. JA 654. In response, Morris told Adell and Dlugokinski to drive out to the Bloomfield Hills area and check out the prices for a one acre lot, suggesting that by doing so they would discover that the price Adell paid for his 1.8 acre lot was "actually reasonable." JA 473-74. Morris also reminded Adell and Dlugokinski that Adell had signed the Settlement Agreement and the Warranty Deed, both of which showed the cost of the land as $1.75 million. JA 473.

12. During the June 3 meeting, Shekerjian tried to resolve the matter by offering to buy the property back. JA 655. Not only did Adell refuse Shekerjian's offer, JA 655, he also threatened to file an involuntary bankruptcy petition against JRH, asking Shekerjian, "Can the company take the hit to its reputation if an involuntary bankruptcy petition was filed?" JA 469-70. Adell denied this, JA 859, 917, but the bankruptcy court found his denial not credible, 291 B.R. at 733. Morris told Adell that filing such a petition would be improper; he also cautioned Adell and Dlugokinski again that, in his opinion, any contacts Adell or his representatives made with JRH's vendors or suppliers would be improper. JA 470.

13. After the June 3 meeting, Morris sent three letters to Dlugokinski, all dated June 5, 2002. JA 475.

a. One letter dealt with Adell's threat to file an involuntary bankruptcy petition. Morris reminded Dlugokinski that Adell had already been warned not to contact JRH's contractors, yet since that warning Adell had solicited another JRH contractor to participate in an involuntary bankruptcy petition. JA 807. He also advised Dlugokinski that "your client would be subject to severe sanctions for damages in the event it files a frivolous petition for bankruptcy. The sanctions include costs, attorneys' fees and punitive damages." JA 807. Morris continued: "In our opinion, your client has already gone way too far. Once again, we request that you immediately tell your client to cease and desist all attacks and disparagement against our client; and all attempts to solicit the filing of an involuntary bankruptcy petition." JA 808.

b. Another letter addressed the issue of the land value. In that letter, Morris urged Dlugokinski to engage in his own research as to the value of the real property purchased by Adell, stating that "we believe that upon inquiry you will determine that there are many lots in Bloomfield Hills that are priced well in excess of $1,000,000.00. Indeed, we have little doubt that you will not only learn this to be true, but also will discover that for a lot as unique as the lot purchased by Mr. Adell,

consisting of 1.8 acres in a prime location, that the sales price was fair and reasonable." JA 817. The letter also noted that "the closing statement clearly indicated that the land was being transferred for the price of $1,750,000.00" and that "[a]t all times, Mr. Adell was accompanied by professionals advising him in connection with this transaction. Mr. Adell was given a warranty deed to the property at closing, and is now the owner of that property." JA 817-18. Referring to Adell's representation at their June 3 meeting that he had retained another builder, Morris wrote: "If Mr. Adell elects to retain another builder, he will be in breach of the residential building and purchase agreement." JA 818. He concluded: "As things now stand, Mr. Adell has terminated and, in our opinion, breached the building and purchase agreement. Our client has not been permitted to continue with its work on your client's property. We are, therefore, notifying you that our client intends to seek damages as a result of this breach of agreement." JA 818.

c. The third letter Morris sent to Dlugokinski on June 5 was "for settlement purposes only" and stated:

> Please contact us to discuss this matter. We stand ready to provide reasonable assurances as to our client's ability and intention to proceed with the construction of your client's home. In

> the alternative, we should be able to find common ground and resolve the claims of your client, particularly once your client learns the true market value of the lot he purchased.

JA 819.

14. On June 6, 2002, without responding to any of Morris's letters, Dlugokinski, on behalf of Adell, filed suit against JRH and Shekerjian in the Oakland County Circuit Court. The complaint included a number of claims (e.g., fraud and misrepresentation, silent fraud, innocent fraud, conspiracy to defraud and evade the Builder's Trust Fund Act and Construction Lien Act, breach of contract, and Consumer Protection Act violations), all of which essentially rested on two allegations: (1) that Shekerjian and JRH had orally told Adell that the land was worth $1 million and that the home they would construct for him would have a value of $2,000,000, despite the fact that the executed sale documents allocated $1.75 million to the value of the land; and (2) that Shekerjian and JRH had told Adell that building would begin immediately after the sale closed, even though they knew that would be impossible because of "water problems" on the property, and that the ensuing delay in commencing construction was not "reasonable." JA 721-22, 726-27, 186, 656, 719-46.

15. On June 14, 2002, Adell contacted Cynthia Weaver, an employee of E.W. Kitchens, a supplier for and creditor of one of JRH's affiliates. JA 499. Adell told Weaver that he had purchased property and was having a home built by JRH,

but that he was having problems with JRH. JA 503. For example, he (falsely) told her that Erb Lumber had refused to deliver lumber to his property because JRH owed them money. JA 503, 647. He also told her that "he was a very rich man, that he was a very angry man," and that "he was looking for creditors to sign with him to force [JRH] into bankruptcy." JA 500. Finally, he told Weaver that it would not cost her anything, but that if she wanted to be paid, that was the only way. JA 500. Adell denied making any of these statements, JA 849-51, but the bankruptcy court found that Adell's denials lacked credibility. 291 B.R. at 733. Adell gave Weaver the name of an attorney to call to verify his information. JA 500. Weaver called the attorney, Michelle Didorosi, who confirmed everything Adell had said. JA 502.

16. Around the same time as he contacted Weaver, Adell also contacted Robert Clark, an employee of Motor City Stone, an underground excavating company and a creditor of JRH (or its affiliates). JA 525-27. In the first call, Adell told Clark that only people who signed on to the involuntary petition would be paid; in the second call he threatened to make certain that people who did not sign on would not be paid. JA 525. Again, Adell denied making any such statements, JA 854, but the bankruptcy court found his denials not credible. 291 B.R. at 733. Clark told Adell that he would have to "pass" on joining the petition on the advice of his accountant who told him it would not be in his "best interest." JA 528-30.

17. On June 17, 2002, an attorney representing JRH in the state court civil action sent a letter to Dlugokinski, stating:

Appendix A

It has come to my client's attention that your client, Mr. Adell, and/or Mr. Adell's agents, is calling and otherwise communicating with the contractors and sub-contractors of John Richards Homes and telling them the following:

> (a) that John Richards Homes is in a troubled financial condition and is generally not paying its bills as they become due;
>
> (b) that Adell has a legal basis to force John Richards Homes into involuntary Chapter 7 bankruptcy, and will force John Richards Homes into Chapter 7 bankruptcy; and
>
> (c) that John Richards Homes had wrongfully diverted funds paid by Adell for the construction of his home.

These statements are false and are obviously designed to have the effect of damaging and/or destroying the longstanding relationship of John Richards Homes with its contractors and subcontractors, by falsely causing these contractors and subcontractors to regard John Richards Homes as not honoring its financial obligations, as being financially insecure, as having no credit and as being insolvent.

JA 801.

18. On June 18, 2002, JRH and Shekerjian jointly filed in the state court civil suit: (1) an answer denying the substance of Adell's claims; (2) affirmative defenses; and (3) a verified counter-complaint alleging breach of contract, business defamation, business libel, injurious falsehood, tortious interference with business relationships and extortion. JA 747-777. JRH also asked the court for a temporary restraining order and a preliminary injunction to enjoin Adell "from communicating in any manner about John Richards Homes with any of the contractors, subcontractors and suppliers, financial institutions, architects, clients and other persons and entities with which John Richard Homes does business, pending the determination of this matter." JA 776.

19. Also on or about June 18, 2002, another of JRH's attorneys, Steven Howell, called Bob Carson, an attorney he believed had been retained by Adell to file an involuntary bankruptcy petition, to "try to explain facts and circumstances from John Richards Homes' perspective" and to tell him that he thought filing an involuntary petition would be "extremely ill-advised and improper" because "there were two sides to the story," "that the story relating to these two parties was one that was the subject of dispute" and "extremely contentious," and that the Adell's claim against JRH was "involved in litigation in Oakland County Circuit Court." JA 487-88. Howell also told Carson that JRH would contest any bankruptcy petition. JA 488.

20. On June 24, 2002, Adell filed an involuntary bankruptcy petition against JRH. JA 28. The petition alleged that JRH was "generally not paying [its] debts as they become

due, unless such debts are the subject of a bona fide dispute." JA 28 (citing 11 U.S.C. § 303(b)). Adell's own claim against JRH, according to the petition, was for fraud and breach of contract in the amount of $800,000. JA 29. The petition was signed by Adell and one of his bankruptcy attorneys, Arnold Schaefer.

21. Before filing, Adell had been advised by Max Newman, the bankruptcy attorney who oversaw the preparation and execution of the involuntary bankruptcy petition, that it was of critical importance that he have an undisputed claim over $12,000 and that if JRH did dispute his claim, "there would be a big problem." Relying solely on Adell's (and his attorneys') assurances, Newman believed JRH would admit a claim in the range of $130,000. JA 940. He used the $800,000 figure to avoid any risk that the court would think Adell's entire claim was limited to a smaller amount. JA 940. Adell had not informed Newman, however, about Morris's June 5 letters to Dlugokinski clearly stating that JRH would dispute any debt to Adell or about JRH's answer to Adell's state court civil complaint denying any debt to Adell. JA 943-45. As for JRH's solvency, Newman relied in part on Adell's representation that Shekerjian had offered to return his money but with credit terms because he didn't actually have the money available. He also learned that State of Michigan records showed approximately 20 or 21 entities with names similar to JRH, suggesting to him that JRH was a single purpose entity, that he had not found a builder's license in the name of JRH, and that Adell's check to JRH had been deposited in a different entity. JA 937-39.

22. Shortly before filing, Adell contacted Michael Layne, a partner in the public relations firm, Marx Layne. JA 531-32. He retained the firm "to make the news media aware of the bankruptcy filing against [JRH]." JA 535, 561-62. He told Layne that he thought "he was being screwed by the bank and his developer." JA 551. His claim that he filed because "the trades weren't getting paid and his house wasn't getting built," JA 551, 561-562, was not credited by the bankruptcy court. Ultimately Marx Layne, at the "express bidding" of Adell, contacted three newspapers to inform them about Adell's filing an involuntary petition against JRH: the Detroit News, the Detroit Free Press and Crain's Detroit Business. JA 535-36, 542, 834-35.

23. On June 25, 2002, the day after the involuntary petition was filed, a Marx Layne representative sent separate e-mail messages to reporters for the Detroit News and the Detroit Free Press announcing that the petition had been filed and asserting that recent "payoffs" by JRH to its creditors "won't do any good." JA 538, 834, 836. Each message listed nine allegedly dissatisfied JRH customers, JA 834-37, the names given to Adell by Bjorkly, JA 859-60, JA 890, and passed on to Marx Layne by Adell's secretary. None had ever been contacted directly by Adell or anyone from Marx Layne. JA 543-44, JA 860. At least two of the nine, Jean McIntyre[1] and Larry Gainer,[2]

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1. Jean McIntyre testified that her home was completed in April 2002, that she had never spoken with anyone from Marx Layne nor seen the e-mail with her name in it, and that she was very happy with her home and had no complaints against JRH. JA 986.

2. Larry Gainer testified that JRH began constructing his home in June 2002, that work was still being done, but he had moved in in

(Cont'd)

in fact had no problems with JRH. JA 984-990. These e-mails also announced that a hearing in the state court civil suit set for the following week was "sure to be worthy of coverage with plots and subplots and high profile business people coming to the surface" and falsely stated that the recipient was the only reporter in the area with this information. JA 539-42, 834, 836. Finally, each message stated, "We would appreciate you keeping our name out of any conversations regarding this high-profile story." JA 834, 836. On July 1, 2002, Marx Layne faxed a copy of the involuntary bankruptcy petition to a reporter with Crain's Detroit Business, along with same list of purportedly dissatisfied JRH customers. JA 820-824. Ultimately, Crain's ran a single sentence announcing the filing. JA 537.

24. On June 26, 2002, one of JRH's bankruptcy attorneys, Steven Howell, called Schaefer and told him that he thought the petition was improper because, *inter alia,* Adell's claim was the subject of litigation. JA 490. Schaefer indicated that he thought some portion of the claim was undisputed, which Howell denied. JA 491.

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25. Agreeing with JRH that Adell's claim was subject to a bona fide dispute, the bankruptcy court granted JRH's motion to dismiss the petition.

(Cont'd)

December 2002, that he had never seen the Marx Layne e-mail or talked to anyone from Marx Layne, and that he had no claims against JRH and was happy with their work. JA 988-89.

APPENDIX B — OPINION AND ORDER OF THE UNITED STATES DISTRICT COURT, EASTERN DISTRICT OF MICHIGAN, SOUTHERN DIVISION DATED AUGUST 5, 2004

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

BANKR. CASE NO. 02-54689

CIVIL CASE NO. 03-40109

In re: JOHN RICHARDS HOMES BUILDING COMPANY, L.L.C.,

Debtor.

KEVIN ADELL,

Appellant,

v.

JOHN RICHARDS HOMES BUILDING COMPANY, L.L.C.,

Appellee.

HONORABLE PAUL V. GADOLA
U.S. DISTRICT JUDGE

Appendix B

OPINION AND ORDER AFFIRMING THE DECISION OF THE BANKRUPTCY COURT

On April 25, 2003, the Honorable Steven W. Rhodes, Chief Judge, United States Bankruptcy Court for the Eastern District of Michigan, entered a $6,413,230.68 judgment in favor of Appellee John Richards Homes Building Company ("JRH") and against Appellant Kevin Adell pursuant to 11 U.S.C. § 303(i). Thereafter, Mr. Adell instituted this appeal. *See* 28 U.S.C. § 158(a)(1). The Court heard oral arguments on the appeal on April 20, 2004. For the reasons set forth below, the Court will affirm the bankruptcy court's judgment.

I. BACKGROUND

JRH builds luxury homes. JRH is one of several construction-related entities run by John and Janet Shekerjian. On December 28, 2001, JRH and Mr. Adell entered into a contract for the sale of a 1.8 acre parcel of land in Bloomfield Hills, Michigan, and for the construction of a home on that land in exchange for $3,030,000.00.

The contract required JRH to commence construction within a reasonable time after the contract was signed, the plans were completed, and a permit was issued. The sale closed on February 28, 2002. The closing papers allocated $1,750,000.00 for the purchase of the land and the balance, $1,280,000.00, for the construction of the home.

Thereafter, two primary disputes developed. First, Mr. Adell asserted that the true value of the land was $1,000,000.00 rather than the $1,750,000.00 stated in the

closing papers and in the deed. Thus, Mr. Adell contended that the excess of $750,000.00 was actually an improper initial construction draw to which JRH was not entitled. Second, Mr. Adell asserted that the delays in commencing construction were unreasonable.

On June 6, 2002, Mr. Adell filed suit in the Oakland County Circuit Court against JRH and others, alleging fraud and misrepresentation, silent fraud, innocent fraud, breach of contract, Consumer Protection Act violations, unjust enrichment, accounting, and constructive trust. On June 18, 2002, JRH filed an answer denying the substance of Mr. Adell's claims and affirmative defenses as well as a counter-complaint alleging breach of contract, business defamation, business libel, injurious falsehood, tortious interference with business relations, and extortion. Further, JRH filed an emergency motion for a temporary restraining order and a preliminary injunction. These filings by JRH are important because they indicate that Mr. Adell's claims against JRH were in dispute.

On June 24, 2002, Mr. Adell filed an involuntary bankruptcy petition against JRH in the United States Bankruptcy Court for the Eastern District of Michigan. The involuntary petition was assigned Bankruptcy Case No. 02-54689 and is the origin of this appeal. The involuntary petition alleged that Mr. Adell had an undisputed claim against JRH for $800,000.00 due to JRH's purported fraud and breach of contract. Mr. Adell alleged that he was eligible to file the involuntary petition under 11 U.S.C. § 303(b) because he had a claim against JRH that was not the subject of a bona fide dispute.

Appendix B

When relief is sought under § 303(b), the claim against the alleged debtor cannot be "contingent as to liability or the subject of a bona fide dispute." 11 U.S.C. § 303(b)(1). Accordingly, "[i]f there is a legitimate legal or factual basis for the alleged debtor not to pay the claim, then the creditor is not eligible to file an involuntary petition." *In re Troutman Enters., Inc.*, 253 B.R. 8, 12 (6th Cir. BAP 2000).

On July 1, 2002, JRH filed a motion to dismiss the involuntary petition. JRH asserted that Mr. Adell's claim was the subject of a bona fide dispute, as the underlying dispute was still in the very early stages of contested litigation in Oakland County Circuit Court. Moreover, JRH contended that Mr. Adell's involuntary petition was filed in bad faith and that, as a result, JRH was entitled to compensatory and punitive damages as well as attorney fees and costs under § 303(i).

On July 15, 2002, the bankruptcy court dismissed Mr. Adell's involuntary petition, finding that Mr. Adell "knew or surely must have known that his claim was the subject of a bona fide dispute, and therefore that he was not qualified to be a petitioning creditor." Mr. Adell did not appeal that dismissal. Therefore, the issue of whether that dismissal was proper—i.e., whether Mr. Adell's claim was the subject of a bona fide dispute—is not before the Court. In other words, the dismissal of Mr. Adell's involuntary petition was proper because his claim was the subject of a bona fide dispute.

Further, at the time of dismissal, the bankruptcy court found that the record was insufficient to determine if, as JRH alleged, Mr. Adell had filed his petition in bad faith, and, if

so, the appropriate amount of damages to which JRH was entitled under § 303(i). Therefore, the bankruptcy court directed the parties to conduct discovery into the matter and set a trial date. The bankruptcy court conducted a bench trial on December 18, 2002, and January 14, 2003.

On April 25, 2003, the bankruptcy court concluded that the involuntary petition was filed in bad faith, issued an opinion regarding JRH's damages, and entered a $6,413,230.68 judgment under § 303(i) in favor of JRH and against Mr. Adell: $4,100,000.00 in compensatory damages, $2,000,0000 in punitive damages, $285,379.00 in attorneys fees, and $27,851.68 in costs. *See In re John Richards Homes Bldg. Co., L.L.C.,* 291 B.R. 727, 731-40 (Bankr.E.D.Mich. 2003). On May 2, 2003, Mr. Adell instituted this appeal.

II. STANDARD OF REVIEW

"District courts review a bankruptcy court's conclusions of law de novo." *In re McNamara,* 275 B.R. 832, 835 (E.D.Mich.2002) (Gadola, J.). "A district court will not disturb a bankruptcy court's findings of fact, however, unless those findings were clearly erroneous." *Id.* Further, "[m]ixed questions of law and fact must be separated into their constituent parts and each analyzed using the appropriate standard of review." *In re Eagle-Picher Indus., Inc.,* 285 F.3d 522, 527 (6th Cir.2002).

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III. ANALYSIS

In the body of his appellate brief, Mr. Adell challenges four aspects of the bankruptcy court's decision. First, Mr. Adell contends that his involuntary petition was not filed in bad faith. Second, Mr. Adell claims that the bankruptcy court's compensatory damages determination was substantially flawed. Third, Mr. Adell argues that the bankruptcy court erred in awarding punitive damages. Fourth, Mr. Adell contests the bankruptcy court's award of fees and costs.

A. Bad Faith

In his primary attack, Mr. Adell contends that his involuntary petition was not filed in bad faith. Whether a § 303 involuntary petition is filed in bad faith is a question of fact, which is reviewed under the deferential standard of clearly erroneous. *See In the of Matter Washtenaw/Huron Inv. Corp. No. 8,* 160 B.R. 74, 79 (E.D.Mich.1993); *In re Landmark Distribs., Inc.,* 189 B.R. 290, 309 (Bankr.D.N.J. 1995).

After examining the totality of the circumstances, *see Washtenaw/Huron,* 160 B.R. at 78-79; *In re Cadillac by DeLorean & DeLorean Cadillac, Inc.,* 265 B.R. 574, 581-82 (Bankr.N.D.Ohio 2001), the bankruptcy court determined that Mr. Adell filed his involuntary petition against JRH in bad faith as a means of (1) intimidating JRH's principal, Mr. Shekerjian, into a settlement of the underlying disputes and, when that failed, (2) damaging and/or destroying Mr. Shekerjian's business.

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The bankruptcy court supported this determination with seven findings. One, when Mr. Adell filed this involuntary bankruptcy petition, he knew or should have known that, given the procedural posture of the lawsuit in Oakland County, his claims against JRH were the subject of a bona fide dispute. Two, Mr. Adell knew of the serious harm that JRH would suffer as a direct consequence of the involuntary filing and intended to cause such harm.[1] Three, this threatening behavior was consistent with Mr. Adell's prior threats of criminal prosecution against Mr. Shekerjian. Four, although Mr. Adell's involuntary petition (signed under penalty of perjury) stated that Mr. Adell had an $800,000.00 claim against JRH for fraud and breach of contract, Mr. Adell was unable to articulate how that amount was calculated. Five, Mr. Adell used improper threats and flaunted his wealth in an attempt to solicit creditors to join his involuntary petition. Six, Mr. Adell deliberately withheld evidence from his bankruptcy counsel thereby invalidating Mr. Adell's testimony that he filed the petition in reliance on the advice of experienced bankruptcy attorneys. Seven, Mr. Adell falsely testified that in filing the involuntary petition, he was motivated by a concern for JRH's trade creditors.[2]

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1. The bankruptcy court found that (1) prior to filing the involuntary petition, Mr. Adell threatened Mr. Shekerjian during a meeting about underlying disputes by asking: "Can your company take the hit to its reputation if an involuntary bankruptcy [is] filed?" and (2) Mr. Adell hired a public relations firm to publicize his involuntary bankruptcy filing against JRH. *JRH*, 291 B.R. at 732.

2. The bankruptcy court reasoned that, if Mr. Adell "were indeed so charitably motivated, he would not have threatened at least two creditors that the only way they would be paid would be to join in the petition." *JRH*, 291 B.R. at 735.

Appendix B

On appeal, Mr. Adell raises two challenges to tne bankruptcy court's bad faith determination. First, Mr. Adell claims that he did, in fact, have an undisputed claim against JRH for $133,000.00. Second, Mr. Adell alleges that his reliance on advice of counsel negates a finding of bad faith.

1. Undisputed Claim

In the involuntary petition in this case, Mr. Adell stated that he had an undisputed claim for fraud and breach of contract against JRH in the amount of $800,000.00. *See* 11 U.S.C. § 303(b)(1); *Troutman,* 253 B.R. at 12. The bankruptcy court dismissed the petition, however, because it concluded that Mr. Adell's claim was the subject of a bona fide dispute, and Mr. Adell elected not to appeal that dismissal. Now, on appeal of the bankruptcy court's bad faith determination, Mr. Adell argues that there was indeed an undisputed claim against JRH for $133,000.00, and, as a consequence, he contends that this undisputed claim demonstrates that he did not file the involuntary petition in bad faith.

Mr. Adell's argument regarding this $133,000.00 claim is as follows. In the early stages of the contractual relationship, Mr. Adell paid JRH $133,000.00 toward construction costs. Mr. Shekerjian did not deposit this amount into JRH's account; rather he deposited the $133,000.00 into the account of a related entity known as John Richard Homes Construction, LLC. Mr. Adell argues that by not retaining his $133,000.00, JRH "indisputably" committed a breach of trust in violation of the Michigan Builders' Trust Fund Act

("MBTFA"). *See* Appellant Br. at 10; Mich. Comp. Laws § 570.151.[3] Mr. Adell therefore concludes that the $133,000.00 claim was not the subject of a bona fide dispute.

This argument does not support a reversal of the bankruptcy court's bad faith determination for two reasons.

a. Even if Mr. Adell's legal analysis of the purported breach of trust is accurate and he was entitled to the $133,000.00 in question, this claim was still, contrary to Mr. Adell's conclusion, the subject of a bona fide dispute at the time he filed the involuntary petition. It was the subject of a bona fide dispute because JRH had "a legitimate legal [and] factual basis" for not paying this $133,000.00 claim. *Troutman,* 253 B.R. at 12; *see also In re Eastown Auto Co.,* 215 B.R. 960, 965 (6th Cir. BAP 1998).

JRH raises the following four points that adequately demonstrate its legitimate basis for not paying the $133,000.00 claim. First, although the funds were deposited in a JRH-related entity, which Mr. Shekerjian identified as a common paymaster, Mr. Shekerjian testified at trial that the funds were still held in trust for Mr. Adell's construction project. In fact, JRH filed a summary disposition motion in

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3. "In the building construction industry, the building contract fund paid by any person to a contractor, or by such person or contractor to a subcontractor, shall be considered by this act to be a trust fund, for the benefit of the person making the payment, contractors, laborers, subcontractors or materialmen, and the contractor or subcontractor shall be considered the trustee of all funds so paid to him for building construction purposes." Mich. Comp. Laws § 570.151.

the Oakland County lawsuit accompanied by an affidavit establishing that the funds in question were held in trust. JRH provided a detailed accounting in the Oakland County suit showing that a portion of the funds were used for construction purposes (e.g., architectural drawings and foundation excavation) and that the remainder was held in trust for future construction expenses for Mr. Adell's construction project.

Second, the MBTFA does not mandate a particular form or procedure for handling such trust funds. *See People v. Miller,* 78 Mich.App. 336, 345, 259 N.W.2d 877, 882 (1977). Rather, the MBTFA only prohibits the use of construction funds for purposes other than the project for which the funds were paid. *See* Mich. Comp. Laws 570.152.[4] Thus, "contractors [have] some measure of discretion in handling the trust funds" under the MBTFA, and JRH arguably acted within the scope of this discretion. *Miller,* 78 Mich.App. at 345, 259 N.W.2d at 882.

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4. "Any contractor or subcontractor engaged in the building construction business, who, with intent to defraud, shall retain or use the proceeds or any part therefor, of any payment made to him, *for any other purpose than to first pay laborers, subcontractors and materialmen, engaged by him to perform labor or furnish material for the specific improvement,* shall be guilty of a felony in appropriating such funds to his own use while any amount for which he may be liable or become liable under the terms of his contract for such labor or material remains unpaid, and may be prosecuted upon the complaint of any persons so defrauded, and, upon conviction, shall be punished by a fine of not less than 100 dollars or more than 5,000 dollars and/or not less than 6 months nor more than 3 years imprisonment in a state prison at the discretion of the court." Mich. Comp. Laws § 570.152 (emphasis added).

Third, JRH maintains that the other entity into which the funds were deposited was merely acting as JRH's agent, and there was nothing improper about JRH holding the funds in trust via its agent.

Fourth, JRH argues that money is fungible: if a contractor is required to hold $133,000.00 in trust, the law does not require the contractor to hold that specific $133,000.00 in trust; so long as the contractor has $133,000.00 at its disposal to pay construction costs, the contractor has complied with the MBTFA. *See Blair v. Trafco Prods., Inc.*, 142 Mich.App. 349, 355, 369 N.W.2d 900, 903 (1985) ("[T]he law presumes that the trust fund was not paid out so long as an amount equal to the trust fund remained.").

Therefore, whether the funds were held in trust was a legitimate dispute. Similarly, whether the deposit of funds into an entity other than JRH constituted a violation of the MBTFA was also a legitimate dispute. In other words, Mr. Adell's $133,000.00 claim was the subject of a bona fide dispute because there was a genuine issue of material fact concerning JRH's liability, as well as several "meritorious contention[s] as to the application of law." *Eastown*, 215 B.R. at 965. This conclusion is actually bolstered by Mr. Adell's oral argument here on appeal: during his oral argument before this Court, Mr. Adell's appellate counsel raised questions about the aforementioned *Blair* case, which thereby further demonstrates the existence of bona fide dispute on the MBTFA issue. *See Blair*, 142 Mich.App. at 355, 369 N.W.2d at 903; *Eastown*, 215 B.R. at 965. Consequently, Mr. Adell's argument concerning the purportedly undisputed $133,000.00 claim does not warrant reversal of the bankruptcy court's bad faith determination because it does not show that the determination was clearly erroneous.

b. There is another reason why Mr. Adell's argument about the $133,000.00 claim does not support reversal. Again, Mr. Adell's argument on appeal is as follows: I should not be held liable for acting in bad faith because I was motived by a good faith objective (i.e., the purportedly undisputed $133,000.00 claim) in bringing the involuntary petition.

In determining whether a petitioner has brought an involuntary petition in bad faith, a court is called upon to ascertain the petitioner's motives for filing the petition. *See Cadillac*, 265 B.R. at 581. In other words, a court must ask: what is the purpose or the objective of the petition? Or, more specifically: what is the undisputed claim at issue?

Before the bankruptcy court dismissed Mr. Adell's petition, it held a hearing regarding JRH's motion to dismiss on July 15, 2002. At this hearing, the bankruptcy court pressed Mr. Adell's attorney, Arnold Schafer, to describe the exact nature of Mr. Adell's allegedly undisputed claim, and the attorney did not even allude to the $133,000.00 breach-of-trust claim raised here on appeal. The transcript is quite telling on this point:

> THE COURT: Well, what is your claim, and how do you deal with the assertion that it is subject to a bona fide dispute?
>
> MR. SCHAFER: Number one, if [JRH] does not have a license,[5] they can't assert any defense they can't defend.

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5. This argument was incorrect. At all times pertinent to this controversy, JRH possessed a valid residential construction license issued by the Michigan Department of Consumer and Industry Services.

THE COURT: Right. But what is your claim?

MR. SCHAFER: That's one.

THE COURT: No, but what's your claim? What do you seek? What's the theory?

MR. SCHAFER: I seek damages for breach of contract.

THE COURT: What's the breach?

MR. SCHAFER: Failure to get this house started as promised. The second— this house cannot be built for the [$3,030,000.00 purchase price], and there will be plenty of expert testimony that I can show you that with. So whether there is a portion of our debt—you can't just say my debt is disputed and therefore go away. There has to be an underlying basis. . . . I'm saying one, they can't dispute it as a matter of law because there is no license, and two, . . . this extra $277,000 [allocated to the price of the land] that appeared from one day to the next day is an undisputed chunk. And third, they can't produce the house.

THE COURT: Well, but [JRH's] position is that given your client's agreement to that purchase price, at a minimum there's a bona fide dispute about it, about—your claim in that regard.

MR. SCHAFER: Ultimately it doesn't matter. The issue is not how much the allocation[6] is to a particular piece of land; the issue is can this house be built . . . . So can this house be built for [$3,030,000.00]? They up-fronted it. They can't perform the contract. . . .

THE COURT: Right. So why—why shouldn't the Court hold that there is a bona fide dispute about that?

MR. SCHAFER: Because it is not bona fide. Because I can introduce testimony a yard long that says this house with these specs cannot be produced.

THE COURT: Why would your client enter into an agreement to build a house at a price that's impossible? Why would your client do that, unless he wanted to buy litigation.

MR. SCHAFER: It wasn't impossible until the allocation occurs.

THE COURT: But that's the allocation your client agreed to.

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6. The closing papers allocated $1,750,000.00 for the purchase of the land and the balance, $1,280,000.00, for the construction of the home.

MR. SCHAFER: With reservations. . . . As I indicated, the day before the closing, the allocation to the lot went up $277,000 . . . .

THE COURT: Is there anything in this record from any witness in support of your position here that this house can't be built for the amount of the contract? . . .

MR. SCHAFER: [No, but] it's easily showable. . . .

THE COURT: Well, how do you deal with the argument of law that says that step one in an involuntary bankruptcy process is first to determine whether the creditor . . . in this case your client—is permitted to file because the claim is not a bona fide dispute? . . .

MR. SCHAFER: Because I don't think there is a bona fide dispute. It is *almost indisputable* that they can't build the house for the money.

THE COURT: Okay. Anything further?

MR. SCHAFER: No, your Honor.

Tr. (July 15, 2002) at 20-23 (emphasis added).

At oral argument, this Court asked Mr. Adell's appellate counsel to explain why Mr. Schafer failed to raise the $133,000.00 breach-of-trust claim on July 15, 2002. After fumbling for an answer, Mr. Adell's appellate attorney bluntly

asserted that Mr. Schafer had made a mistake. This explanation is dubious given transcript segments above and Mr. Schafer's reputation as a topnotch bankruptcy attorney.

Moreover, Mr. Adell's written response to JRH's motion to dismiss, which was signed by Mr. Schafer's partner, Max Newman, is likewise devoid of any specific reference to a breach of trust or the allegedly undisputed $133,000.00 claim now raised here on appeal. *See* Adell Resp. (July 12, 2002) at 9-10.

Therefore, a mere three weeks after Mr. Adell filed his involuntary petition, the bankruptcy court gave Mr. Adell's attorney a golden opportunity to explain Mr. Adell's undisputed claim, and the proffered explanations did not include anything vaguely resembling the $133,000.00 claim raised here on appeal, which, according to Mr. Adell's appellate briefs, Mr. Schafer and Mr. Newman supposedly identified as an undisputed claim prior to filing the involuntary petition.

If this $133,000.00 claim was as vital and as salient as Mr. Adell now suggests here on appeal, he and his former attorneys would have voraciously raised the issue in response to JRH's motion to dismiss the involuntary petition. Instead, at the time the petition was instituted, Mr. Adell and his former attorneys proceeded as if this purported good faith objective did not exist. The failure to explicitly raise this claim when given the opportunity to do so by the bankruptcy court is a strong indication that this claim was not an objective behind the involuntary petition at the time the petition was filed. Rather, this purported good faith objective was

manufactured after the fact, and the involuntary petition was motivated by other objectives, such as Mr. Adell's bad faith as found by the bankruptcy court. Given the utter implausibility of the $133,000.00 claim serving as a genuine reason for bringing the involuntary petition, this argument does not undermine the bankruptcy court's determination that Mr. Adell filed the petition in bad faith because it does not show that the determination was clearly erroneous.

2. Advice of Counsel

Mr. Adell further contends that his reliance on advice of counsel— i.e., his aforementioned bankruptcy attorneys, Mr. Schafer and Mr. Newman as well as their firm, Schafer & Weiner—in filing the involuntary petition vitiates the bankruptcy court's bad faith determination.

"Reliance on counsel does not excuse bad faith in the filing of an involuntary petition, but it may be considered on the favorable side of the ledger in such a consideration." Appellant Br. at 20 (quoting *In re Apache Trading Group, Inc.*, 229 B.R. 891, 894 (Bankr.S.D.Fla.1999)). Here, the bankruptcy court considered Mr. Adell's reliance on advice of counsel and rejected it because Mr. Adell deliberately withheld material information from his counsel that would have, or should have, made a difference on the pivotal issue of whether Mr. Adell's claim against JRH was the subject of a bona fide dispute. Mr. Adell withheld several items including (1) the fact that Mr. Adell explicitly agreed to the $1,750,000.00 allocation of the purchase price for the land as well as (2) JRH's answer and counterclaim from the Oakland County lawsuit. As illustrated by the above-quoted

portions of the July 15, 2002, transcript in which Mr. Schafer erroneously argued that Mr. Adell had an undisputed breach of contract claim, it is clear that Mr. Adell's failure to provide this information to his bankruptcy attorney was material. Accordingly, the bankruptcy court correctly applied the following rule to Mr. Adell in this case: "It is fundamental that a client reasonably relies on an attorney's advice only when the client provides to the attorney *all* of the pertinent facts in the client's possession." *JRH,* 291 B.R. at 734-35 (emphasis added) (citing *United States v. United Med. & Surgical Supply Corp.*, 989 F.2d 1390, 1404 (4th Cir.1993); *C.E. Carlson, Inc. v. Sec. & Exch. Comm'n,* 859 F.2d 1429, 1436 (10th Cir.1988); *United States v. Eisenstein,* 731 F.2d 1540, 1543 (11th Cir.1984) ("In order to take advantage of [the defense of good faith reliance on the advice of counsel], the defendant must show that he relied in good faith after first making a full disclosure of *all* facts that are relevant to the advice for which he consulted the attorney." (emphasis added))). Therefore, the defense of relying on advice of counsel is unavailable to Mr. Adell in this situation.

Moreover, there is an additional reason to reject Mr. Adell's advice-of-counsel argument. The bankruptcy court found that, under the totality of the circumstances, Mr. Adell "proceeded with the wrongful intent to intimidate [Mr.] Shekerjian into a settlement and, when that failed, to damage or destroy his business." *JRH,* 291 B.R. at 735. Further, prior to filing the involuntary petition, Mr. Adell threatened Mr. Shekerjian during a meeting about underlying disputes by asking: "Can your company take the hit to its reputation if an involuntary bankruptcy [is] filed?" *Id.* at 732. Additionally, Mr. Adell hired a public relations firm to publicize his

involuntary bankruptcy filing against JRH. When, as here, the record "contains ample evidence of malice, spite, and ill-will ... in the filing of the involuntary petition," such evidence will "defeat an advice of counsel defense." *Landmark,* 189 B.R. at 318; *see also In re Reveley,* 148 B.R. 398, 408 (Bankr.S.D.N.Y.1992) ("Where the petition is motivated by ill will or malice, reliance upon counsel's advice will not preclude a finding of bad faith on the part of the petitioner."). *Cf. In re Better Care, Ltd.,* 97 B.R. 405, 412-13 (Bankr.N.D.Ill.1989). Therefore, because the record establishes that Mr. Adell vindictively used the involuntary petition to inflict the highest degree of harm possible irrespective of his counsel's advice, he cannot avoid being held accountable for his actions. Thus, Mr. Adell's advice-of-counsel argument does not warrant reversal of the bankruptcy court's bad faith determination.

B. Compensatory Damages

Mr. Adell next claims that the bankruptcy court's compensatory damages determination was substantially flawed. "[D]amages present a question of fact subject to review under the clearly erroneous standard." *Huss v. King Co., Inc.,* 338 F.3d 647, 652 (6th Cir.2003). The bankruptcy court's "unique perspective to evaluate the witnesses and to consider the entire context of the evidence must be respected." *In re Wakefield,* 293 B.R. 372, 382-83 (N.D.Tex.2003).

After determining that Mr. Adell filed his petition in bad faith, the bankruptcy court awarded JRH $4,100,000.00 in compensatory damages pursuant to 11 U.S.C. § 303(i)(2)(A). The bankruptcy court fashioned the award to compensate JRH for its lost profits proximately caused by the bad faith filing.

Appendix B

Mr. Adell now raises four challenges to the bankruptcy count's compensatory damages award. First, the award was impermissibly based on damages of non-parties. Second, future damages were entirely speculative. Third, certain damages were duplicative. Fourth, the bankruptcy court erroneously excluded expert testimony. The first and second arguments will be addressed together.

1. Damages of Non-Parties/Future Damages

At trial, Mr. Shekerjian testified that JRH had not sold a single home since Mr. Adell filed his involuntary petition. Also, JRH lost two high-end construction contracts that were about to close after months of negotiation because the customers were disturbed and confused by the bankruptcy petition. The uncertainty drove them away. Additionally, David Johnson, an official of Victor International Corporation, which is a leading firm in the high-end, luxury home market, testified that purchasers in the million-dollar-plus home market would have serious shortcomings about contracting with JRH because of the risk and uncertainty generated by Mr. Adell's involuntary petition. Further, Mr. Shekerjian and Mr. Johnson testified that the luxury home market remained strong despite the downturn in the economy at the time and that JRH's competitors were starting significant numbers of new homes in the relevant geographic area and price range. Consequently, JRH's loss of business was tied to Mr. Adell's petition and not the economy.

Mr. Adell claims that the compensatory award to JRH was based on the damages of non-parties, that is, Mr. Shekerjian's entities related to JRH. Mr. Adell also contends

that the damages are speculative and, thus, improper. Mr. Adell's arguments, however, are misguided. While the bankruptcy court's compensatory damages calculation drew information from JRH-related entities, out of necessity, as described below, the compensatory award only compensates JRH for its damages. In addition, as described below, the damages were not overly speculative but rather grounded in a reasonable and conservative analysis of the financial harm caused by Mr. Adell's bad faith filing of the involuntary petition.

Prior to 2001, Mr. Shekerjian employed other JRH-related entities to engage in the construction of luxury homes. In January 2001, Mr. Shekerjian elected to streamline his business and created JRH to handle all of the luxury home projects from that point forward. At trial, Tom Frazee, a certified public accountant, testified as JRH's expert witness. Mr. Frazee explained that the best evidence of total sales and profits JRH would have generated but for Mr. Adell's involuntary petition, was the total sales and profit margins of Mr. Shekerjian's JRH-related entities that conducted the same business as JRH now conducts, i.e., the construction of high-end, luxury homes. Mr. Shekerjian's JRH-related entities had a five-year average of constructing approximately eight homes with an average sales price of $1,900,000.00.

Mr. Frazee's analysis assumed that JRH would have built the same number of luxury homes over the next five years, but, after Mr. Adell's petition was filed, JRH would build only half as many homes over the next five years, i.e., four per year. This analysis was conservative for at least two reasons: (1) to that point in time, JRH had not generated any

new building projects since the petition was filed thereby suggesting that the four-per-year figure may be difficult to achieve, and (2) Mr. Shekerjian believed that it would take more than five years to repair JRH's reputation and regain the level of business it had prior to the involuntary petition. *See also* Appellee Br. at 43 n. 46. Nonetheless, using the four-per-year figure along with the identical price and profit margins from the period before the involuntary petition was filed, Mr. Frazee determined JRH's future damages, i.e., lost profits for the forthcoming five years, to be $4,100,000.00. The bankruptcy court adopted this figure.

Damages must be established to a **reasonable certainty**, and the existence of **some uncertainty** as to the amount of damages does not foreclose recovery. *See Broan Mfg. Co., Inc. v. Associated Distribs., Inc.*, 923 F.2d 1232, 1236 (6th Cir.1991); *Blue Diamond Coal Co. v. United Mine Workers of Am.*, 436 F.2d 551, 561 (6th Cir.1970) ("It has long been recognized that once the fact of damage has been properly shown, uncertainty as to their amount will not foreclose recovery." (citations and internal quotations omitted)); *Kulling v. Grinders for Indus., Inc.*, 185 F.Supp.2d 800, 810 (E.D.Mich.2002) ("Nor is it especially worrisome that this element of uncertainty might have had an effect on the calculation of damages. To the contrary, calculations of future damages necessarily must rest upon a degree of prediction. *See Shore v. Fed. Express Corp.*, 42 F.3d 373, 378 (6th Cir.1994) (recognizing that 'future damages are often speculative')."). *See also Malloy v. Monahan*, 73 F.3d 1012, 1016-17 (10th Cir.1996). The record clearly established that Mr. Adell's bad faith filing proximately caused considerable damage to JRH, and JRH provided the bankruptcy court with

sufficient evidence to establish, to a reasonable certainty, JRH's lost profits that were caused by the bad faith filing. Thus, the bankruptcy court's reliance on evidence of total sales and profit margins of JRH-related entities to determine JRH's damages was not clearly erroneous.

2. Duplication

Mr. Adell further contends that certain damages were double counted. Mr. Adell believes that, in the $4,100,000.00 compensatory figure, Mr. Frazee and the bankruptcy court included $640,000.00 in lost profits for the two aforementioned contracts lost by JRH as an immediate and direct result of the uncertainty caused by Mr. Adell's involuntary petition. Thus, Mr. Adell cites this $640,000.00 as duplicative and requests that this $640,000.00 be deducted from the $4,100,000.00 compensatory award.

Mr. Adell is incorrect. This $640,000.00 represented JRH's past damages, not its future damages. The bankruptcy court only awarded future damages. In his testimony, Mr. Frazee made it very explicit that this $640,000.00 amount was not included in his $4,100,000.00 future profit figure. *See* Tr. (Dec. 18, 2002) at 148 ln.5-8 (I "calculated damages there associated with those projects at about $640,000, which would be in addition to the four—$4 million that I discussed previously."); *see also id.* at 147-48. The bankruptcy court elected to only award the $4,100,000.00 figure for future lost profits. Had the bankruptcy court decided to also award the $640,000.00 in question, the total compensatory award would have been in the neighborhood of $4,740,000.00. Consequently, Mr. Adell's argument about duplicative damages is wholly without merit.

3. Expert Testimony

Mr. Adell further maintains that the bankruptcy court erroneously excluded expert testimony. Specifically, the bankruptcy court excluded Mr. Adell's damages expert, Gary Leeman, from testifying at trial.

Rule 26(a)(2) of the Federal Rules of Civil Procedure mandates that, when a party plans on using an expert witness, the party disclose a written report detailing, *inter alia,* the expert's "opinions to be expressed and the basis and reasons therefor." Fed.R.Civ.P. 26(a)(2)(B). "The purpose of Rule 26(a)(2) is to require disclosure of expert testimony sufficiently in advance of trial so that opposing parties have a reasonable opportunity to prepare for effective cross examination and perhaps arrange for expert testimony from other witnesses." *Wheeler v. FDL, Inc.,* No. 02-2444, 2003 WL 22843172, at *1 (D.Kan. Nov.17, 2003) (emphasis added).

When a party fails to disclose information in compliance with Rule 26(a)(2), Rule 37(c)(1) of the Federal Rules of Civil Procedure automatically disallows that party from using such expert evidence at trial unless there was a substantial justification for the noncompliance or unless the noncompliance was harmless. *See Sexton v. Uniroyal Chem. Co., Inc.,* 62 Fed.Appx. 615, 616 n. 1 (6th Cir.2003) ("This circuit has established that Rule 37(c)(1) mandates that a trial court sanction a party for discovery violations in connection with Rule 26(a) unless the violations were harmless or were substantially justified."); *see also Musser v. Gentiva Health Servs.,* 356 F.3d 751, 758 (7th Cir.2004)

("The exclusion of non-disclosed evidence is automatic and mandatory under Rule 37(c)(1) unless non-disclosure was justified or harmless."). Further, the exclusion of evidence under Rule 37(c)(1) is proper even when the exclusion makes "it much more difficult, perhaps almost impossible, for [the violating party] to rebut [the opposing party's] damages calculations." *Yeti by Molly, Ltd. v. Deckers Outdoor Corp.*, 259 F.3d 1101, 1106 (9th Cir.2001).

A trial court's imposition of such a sanction under Rule 37(c)(1) is reviewed under the abuse of discretion standard. *See Sommer v. Davis,* 317 F.3d 686, 692 (6th Cir.2003). "Abuse of discretion is defined as a definite and firm conviction that the trial court committed a clear error of judgment." *Tompkin v. Philip Morris USA, Inc.*, 362 F.3d 882, 891 (6th Cir.2004) (internal quotations omitted). "A [trial] court abuses its discretion when it relies on clearly erroneous findings of fact, or when it improperly applies the law or uses an erroneous legal standard." *Id.*

In this case, upon JRH's motion in limine, the bankruptcy court excluded Mr. Leeman from trial because Mr. Adell failed to provide JRH with a Rule 26(a)(2) report prior to trial. Additionally, Mr. Adell similarly failed to provide an adequate response to JRH's interrogatory about Mr. Leeman's testimony: to JRH's interrogatory requesting "the substance of the facts and opinion to which the expert is expected to testify, and a summary of the grounds for each opinion," Mr. Adell merely responded that Mr. Leeman would testify "as to damages" and this response was never supplemented before trial. *See* Appellee Br. at 31. Nonetheless, after the trial began on December 18, 2002, but before the trial

concluded on January 14, 2003, Mr. Adell filed an expert report for Mr. Leeman on January 7, 2003. The bankruptcy court granted JRH's motion in limine on January 14, 2003.

Mr. Adell lodges two attacks on the bankruptcy court's exclusion of Mr. Leeman's testimony.

a. Mr. Adell first contends that Rule 26(a)(2) is inapplicable in this case. Mr. Adell correctly states that, pursuant to Administrative Order 00-04 of the Eastern District of Michigan, the discovery rules of the Federal Rules of Civil Procedure have been suspended in this judicial district for contested bankruptcy matters. This general suspension is necessary because most bankruptcy matters are quickly resolved and the discovery rules would simply delay the resolution of matters that could and should be expeditiously resolved.

However, pursuant to Administrative Order 00-04, this general suspension can be lifted when a court determines that discovery is necessary in a particular case. Here, the bankruptcy court explicitly ordered discovery. On July 15, 2002, when the bankruptcy court dismissed the involuntary petition, it also found that the record was insufficient to determine whether, as JRH alleged, Mr. Adell had filed his petition in bad faith, and, if so, the appropriate amount of damages to which JRH was entitled under § 303(i). Therefore, the bankruptcy court ordered the parties to engage in discovery into the issues of bad faith and damages. Consequently, the bankruptcy court lifted the general suspension of Administrative Order 00-04 thereby making Rule 26(a)(2) applicable to this case. Thus, Mr. Adell's argument against the applicability of Rule 26(a)(2) in this case is without merit.

b. Mr. Adell also argues that the bankruptcy court abused its discretion in excluding Mr. Leeman's testimony because there was, according to Mr. Adell, a substantial justification for the delay in producing Mr. Leeman's report. Again, a trial court can refrain from excluding evidence under Rule 37(c)(1) for violations of Rule 26(a)(2) if the violating party had a substantial justification for its noncompliance with Rule 26(a)(2). *See* Fed.R.Civ.P. 37(c)(1).

Mr. Adell claims that JRH failed, in violation of a court-appointed discovery master's order in November 2002, to provide financial information important to the production of Mr. Leeman's expert report. Mr. Adell argues that this failure is a substantial justification for the tardiness (i.e., mid-trial disclosure) of his expert report.

Mr. Adell's argument, however, is undermined by two facts. First, approximately three months prior to trial, in September 2002, JRH gave Mr. Adell fifteen boxes of financial documents containing the information that JRH's expert, Mr. Frazee, was using to prepare his damages analysis for trial. Mr. Adell's expert, Mr. Leeman, conceded that this information was produced: in his report of January 7, 2003, Mr. Leeman explicitly refers to the aforementioned boxes and the financial information contained therein. Second, more than two months prior to trial, on October 9, 2002, JRH disclosed its expert report to Mr. Adell. Thus, Mr. Adell's expert had a significant, if not a comprehensive, amount of financial information upon which to base his damages analysis well before trial.

Appendix B

While JRH's failure to comply with discovery master's order is unfortunate and could be considered **some justification** for Mr. Leeman's tardy export report, this failure is not a **substantial justification** under Rule 37(c)(1) given the fact that, before the discovery master's order and well before trial, Mr. Adell had ample financial information to place at his expert's disposal. Additionally, Mr. Adell's expert report was not merely delayed, it was disclosed three weeks after the trial began and one week before the trial ended. Such a mid-trial expert disclosure is clearly contrary to the purpose behind Rule 26(a)(2) of disclosing expert testimony sufficiently in advance of trial so that the opposing party has a reasonable opportunity to prepare for the expert.

Furthermore, "the trial court has enormous discretion in deciding whether a party's violation of the expert report rules is justified" under Rule 37(c)(1). *Sullivan v. Glock, Inc.*, 175 F.R.D. 497, 505 (D.Md.1997); *see also McCarthy v. Option One Mortgage Corp.*, 362 F.3d 1008, 1012 (7th Cir.2004) ("[trial] courts enjoy broad discretion in controlling discovery."); *S. States Rack & Fixture, Inc. v. Sherwin-Williams Co.*, 318 F.3d 592, 597 (4th Cir.2003) (trial courts have "broad discretion" under Rule 37(c)(1)); *Laplace-Bayard v. Batlle*, 295 F.3d 157, 162 (1st Cir.2002) ("[Trial] courts have broad discretion in meting out Rule 37(c) sanctions for Rule 26 violations."); *Jacobsen v. Deseret Book Co.*, 287 F.3d 936, 953 (10th Cir.2002) ("The determination of whether a Rule 26(a) violation is justified or harmless is entrusted to the broad discretion of the [trial] court."); *Pride v. BIC Corp.*, 218 F.3d 566, 578 (6th Cir.2000) ("[Trial] courts have broad discretion to exclude untimely disclosed expert-witness testimony.").

In this case, given the fact that a large amount of financial information was made available to Mr. Adell for the preparation of an expert report well in advance of trial, the bankruptcy court acted well within its broad discretion when it excluded Mr. Leeman's testimony under Rule 37(c)(1). Under the circumstances, it cannot be said that the bankruptcy court relied on clearly erroneous facts or that it improperly applied the law or used an erroneous legal standard. Accordingly, the bankruptcy court did not abuse its discretion in excluding Mr. Leeman's testimony. Reversal on the basis of Mr. Adell's Rule 37(c)(1) argument is unwarranted.

C. Punitive Damages

Mr. Adell further contends that the bankruptcy court erred in awarding $2,000,000.00 in punitive damages under 11 U.S.C. § 303(i)(2)(B).

Mr. Adell's first argument against the award of punitive damages is that, as already discussed above, he acted in good faith and on advice of counsel in filing the petition. As these arguments are rejected above, they are likewise rejected here.

Mr. Adell's second argument against punitive damages is that the $2,000,000.00 amount is excessive because it goes beyond the purposes of punishment and deterrence. The standard of review for an appellate court's review of a lower court's award of punitive damages is as follows:

> [W]here a constitutional challenge to an award of punitive damages is made, [the appellate court] review[s] [the lower] court's determination de

> novo. Where no constitutional issue is raised, [the appellate] court reviews [the lower] court determination of the appropriate amount of punitive damages only for an abuse of discretion. A [lower] court abuses its discretion when it relies on clearly erroneous findings of fact . . . or when it improperly applies the law or uses an erroneous legal standard. Under this standard, [the appellate] court reviews de novo the [lower] court's legal conclusion, and reviews for clear error its findings of fact.

Smoot v. United Transp. Union, 67 Fed.Appx. 328, 329-30 (6th Cir.2003) (internal quotations and citations omitted). In this appeal, Mr. Adell has not raised a constitutional challenge to the bankruptcy court's punitive award; thus, this Court reviews the punitive award only for abuse of discretion.

The congressional purpose behind § 3ʊ3(i) is straightforward:

> [Congress designed § 303(i) because of a] concern . . . that unprincipled creditors would [improperly] use or threaten use of involuntary bankruptcy. . . . For example, an unscrupulous creditor intoxicated by the easy availability of involuntary bankruptcy might seek its seductive company to lever payment of a legitimately disputed obligation, satisfy a personal grudge, or secure a business advantage by eliminating competition. Therefore, to deter those who might otherwise seek to take advantage of the . . . liberal[ ] rules governing

> access to involuntary relief, the drafters incorporated into [§] 303 a provision that . . . the bankruptcy court might assess . . . punitive damages against any petitioning creditor found to have filed in bad faith.

Lawrence Ponoroff, "The Limits of Good Faith Analyses: Unraveling and Redefining Bad Faith in Involuntary Bankruptcy Proceedings," 71 Neb. L.Rev. 209, 212-13 (1992). Mr. Adell's abuse of the involuntary bankruptcy process in this case is precisely the type of conduct that Congress intended to punish and deter through the punitive damages provision of § 303(i)(2)(B). Accordingly, the bankruptcy court properly applied § 303(i)(2)(B), and, as a result, did not abuse its discretion in this regard.

Further, before assessing the punitive award, the bankruptcy court reviewed seven factual findings to support the award:

> [Mr. Adell] was told and knew that JRH contested his claims. He withheld crucial information from his bankruptcy attorneys. He engaged in a campaign of publicity and disparagement with the specific intent to injure JRH. He threatened JRH with criminal prosecution. He flaunted his wealth [in an attempt to solicit creditors to join his involuntary petition]. He cynically asserted a false concern for creditors. He presented no credible mitigating considerations.

JRH, 291 B.R. at 739. Based on the record before this Court, these findings are not clearly erroneous, and, thus, the bankruptcy court's reliance on these findings to award $2,000,000.00 in punitive damages was not an abuse of discretion.

Moreover, while this punitive award appears to be the largest on record for a bad faith involuntary bankruptcy case (the largest to this point being $500,000.00, *see Landmark*, 189 B.R. at 317), it is an appropriate award given Mr. Adell's unprecedented use of the involuntary bankruptcy process to intentionally inflict injury as well as his actions to exacerbate the impact of this injury (e.g., hiring the public relations firm to publicize the involuntary petition).

D. Fees and Costs

Lastly, Mr. Adell also contests the bankruptcy court's award of fees and costs. *See* 11 U.S.C. § 303(i)(A)(1). His only argument, however, is that because he filed the involuntary petition in good faith he should not be held liable for fees and costs. This argument has no substance. It merely states an obvious procedural truth: if this Court reverses the bankruptcy court's bad faith determination, then the Court should vacate the bankruptcy court's award of fees and costs. As such, Mr. Adell's only argument against the fees-and-costs award is completely contingent upon the outcome of his bad faith arguments. Therefore, since the Court will affirm the bankruptcy court's bad faith determination, the Court will also affirm the bankruptcy court's fees-and-costs award.

Appendix B

IV. CONCLUSION

ACCORDINGLY, IT IS HEREBY ORDERED that, for all the reasons set forth above, the judgment of the bankruptcy court and its underlying opinion regarding JRH's damages, dated April 25, 2003, are **AFFIRMED**.

IT IS FURTHER ORDERED that JRH is awarded costs in accordance with Bankruptcy Rule 8014.

SO ORDERED.

s/ Paul V. Garola
HONORABLE PAUL V. GARDOLA
UNITED STATES DISTRICT JUDGE

Dated: August 5, 2004

APPENDIX C — OPINION AND ORDER REGARDING ALLEGED DEBTOR'S DAMAGES OF THE UNITED STATES BANKRUPTCY COURT, EASTERN DISTRICT OF MICHIGAN, SOUTHERN DIVISION ENTERED AND FILED APRIL 25, 2003

United States Bankruptcy Court
Eastern District of Michigan
Southern Division

Case No. 02-54689
Involuntary Petition
(Dismissed)

In re:
JOHN RICHARDS HOMES BUILDING CO., L.L.C.,

Debtor.

Opinion Regarding Alleged Debtor's Damages

Following the dismissal of this involuntary petition, the Court conducted an evidentiary hearing on a request for compensatory and punitive damages by the alleged debtor, John Richards Homes Building Company, L.L.C. ("JRH"). The Court concludes that the petitioning creditor, Kevin Adell, filed this involuntary petition in bad faith and that JRH is entitled to compensatory damages in the amount of $4,100,000 and punitive damages in the amount of $2,000,000. The Court further concludes that JRH is entitled to an award of attorney fees and costs in the amount of $313,230.68.

Appendix C

I.

JRH's request for damages and attorney fees is based on 11 U.S.C. § 303(i), which provides:

> (i) If the court dismisses a petition under this section other than on consent of all petitioners and the debtor, and if the debtor does not waive the right to judgment under this subsection, the court may grant judgment—
>
> > (1) against the petitioners and in favor of the debtor for—
> >
> > > (A) costs; or
> >
> > (B) a reasonable attorney's fee; or
> >
> > (2) against any petitioner that filed the petition in bad faith, for—
> >
> > > (A) any damages proximately caused by such filing; or
> >
> > (B) punitive damages.

11 U.S.C. § 303(i).

Thus, the Court is authorized to award JRH its reasonable attorney fees and costs. In addition, the Court may award compensatory and punitive damages if it finds that Adell filed the involuntary bankruptcy petition in bad faith. "[T]here is

a presumption of good faith in favor of the petitioning creditor, and thus the alleged debtor has the burden of proving bad faith." *United States Fidelity & Guar. Co. v. DJF Realty & Suppliers, Inc.*, 58 B.R. 1008, 1011 (N.D.N.Y. 1986). In *In re Cadillac by DeLorean & DeLorean Cadillac, Inc.*, 265 B.R. 574 (Bankr. N.D.Ohio 2001), the court discussed the bad faith determination under § 303(i) and stated:

> The Sixth Circuit has not addressed this issue. On issues of good faith and bad faith, however, the Sixth Circuit generally looks to the totality of the circumstances. *See Hardin v. Caldwell (In re Caldwell)*, 851 F.2d 852, 860 (6th Cir. 1988); *see also Industrial Ins. Servs., Inc. v. Zick (In re Zick)*, 931 F.2d 1124, 1127 (6th Cir. 1991); *Metro Employees Credit Union v. Okoreeh-Baah (In re Okoreeh-Baah)*, 836 F.2d 1030, 1033 (6th Cir. 1988). This Court, therefore, adopts that as the appropriate test.

Id. at 582.

This Court agrees that in assessing whether Adell filed this involuntary petition in bad faith, it is appropriate to examine the totality of circumstances.

II.

JRH asserts that Adell filed the petition in a bad faith campaign to extort an unreasonable settlement of the parties' dispute and to destroy JRH's business due to Adell's personal antipathy toward John Shekerjian, JRH's principal.

Appendix C

Adell asserts that he filed the petition in good faith. Specifically, he states that he relied on the advice of experienced bankruptcy counsel who, before determining that an involuntary bankruptcy petition would be proper, investigated JRH's financial circumstances and the circumstances of JRH's debt to Adell. He also asserts that in filing the petition, he was motivated by a concern for JRH's trade creditors.

JRH is in the business of constructing new homes priced at over $1 million. Adell's claim against JRH arises from a contract for the sale of property and the construction of a new home. (Ex. 17.) The parties signed this contract on December 28, 2001. Pursuant to the contract, JRH agreed to sell to Adell a 1.8 acre parcel of property in Bloomfield Hills, Michigan, and to construct a home for Adell on the property. Adell agreed to pay a total of $3,030,000. The contract required JRH to commence construction "within a reasonable time after this Agreement is signed and plans are completed and permit is issued." (Ex. 17, para.8.)

The sale closed on February 28, 2002. The closing papers, signed by Adell, reflect that Adell agreed to allocate $1,750,000 for the purchase of the property and the balance to the building construction. (Exs. 1 and 2.) The deed also reflects this purchase price. (Ex. 3.) First Federal of Michigan financed the purchase for Adell.

In the next several months, two primary disputes developed. First, Adell asserted that the true value of the real property was $1 million rather than the $1.75 million stated in the closing papers and in the deed. Thus, he contended

that the excess of $750,000 was actually an improper initial construction draw to which JRH was not entitled. Second, Adell asserted that the delays in commencing construction were unreasonable.

On June 6, 2002, Adell filed suit in the Oakland County Circuit Court against JRH, Shekerjian, First Federal and others, alleging fraud and misrepresentation, silent fraud, innocent fraud, breach of contract, Consumer Protection Act violations, unjust enrichment, accounting and constructive trust. (Ex. 5.)

On June 18, 2002, JRH filed: (1) an answer denying the substance of Adell's claims; (2) affirmative defenses; and (3) a verified counter-complaint alleging breach of contract, business defamation, business libel, injurious falsehood, tortious interference with business relations and extortion. (Exs. 5 and 6.) JRH also filed an emergency motion for a temporary restraining order and a preliminary injunction.

Six days later, on June 24, 2002, Adell filed this involuntary petition against JRH. This petition alleged that Adell's claim was $800,000 for fraud and breach of contract, and that he was eligible to file the petition under 11 U.S.C. § 303(b), i.e., that his claim was not subject to a bona fide dispute.

On July 1, 2002, JRH filed a motion to dismiss. JRH asserted that Adell's claim was the subject of a bona fide dispute, as it was still in the very early stages of contested litigation. JRH also asserted that the petition was filed in bad faith and that therefore, JRH was entitled to substantial compensatory and punitive damages. JRH also requested attorney fees and costs.

Appendix C

On July 15, 2002, after a hearing, the Court dismissed the petition, finding that Adell "knew or surely must have known that his claim was the subject of a bona fide dispute, and therefore that he was not qualified to be a petitioning creditor." (Tr. of July 15, 2002, hr'g at 27-30.) The Court retained jurisdiction to resolve JRH's requests for compensatory and punitive damages and for attorney fees.

III.

After examining the totality of circumstances, the Court finds that JRH has established by a preponderance of the evidence that Adell filed the involuntary bankruptcy petition in bad faith. Indeed, the Court finds that the evidence overwhelmingly supports this conclusion:

1. As the Court found on July 15, 2002, when Adell filed this involuntary bankruptcy petition, he knew or should have known that his claims were the subject of a bona fide dispute. By then, JRH had responded to Adell's state court complaint by filing substantial defenses, affirmative defenses and counterclaims.

Adell testified that he was not aware of these responsive pleadings until after the involuntary bankruptcy petition was filed. There are four problems with this position:

First, his state court attorneys were aware of these pleadings before the petition was filed. His attorneys' failure to advise him of them in a timely way can be of no help to him.

Second, the nature of Adell's claims was such that he would certainly not require legal advice to understand that he and JRH would have real and substantial legal and factual disputes, and further that the litigation to resolve these disputes would be lengthy and costly. Even before JRH filed responsive pleadings, Adell could not have reasonably concluded that JRH would simply admit that it had committed the frauds and the other intentional wrongs that he had alleged.

Third, the evidence establishes that even if Adell was not aware of JRH's responsive pleadings, he already knew that his state court claims would be contested. At least twice before Adell filed the involuntary petition, JRH's attorneys specifically told Adell's attorneys that JRH would contest Adell's claims and that therefore an involuntary petition would be improper. First, after Adell threatened to file an involuntary bankruptcy petition during a meeting on June 3, 2002, attorney E. Michael Morris, representing JRH, sent a letter dated June 5, 2002, to attorney Dennis Dlugokinski, representing Adell. (Ex. 10.) In that letter, Morris advised Dlugokinski that an involuntary petition would be improper and threatened "severe sanctions for damages in the event [Adell] files a frivolous petition for bankruptcy." Then, on or about June 18, 2003, attorney Steven Howell, representing JRH, spoke directly to attorney Bob Carson, representing Adell, and stated that JRH disputed Adell's claims and that the parties' dispute was "extremely contentious." (Tr. of Dec. 18, 2002, hr'g at 55-6.)

Fourth, Adell took no action to withdraw the involuntary petition when he did become aware of JRH's state court responses.

2. Adell knew of the serious harm that JRH would suffer as a direct consequence of the involuntary filing. Indeed the evidence establishes that Adell intended to cause that harm. At a meeting on June 3, 2002, Adell specifically asked Shekerjian, "Can the company take the hit to its reputation if an involuntary bankruptcy was [sic] filed?" (*Id.* at 37-8.) Adell denied this (Tr. of Jan. 14, 2003, hr'g at 77), but the Court finds that his denial lacks credibility.

Further evidence of Adell's intent to harm JRH is Adell's extraordinary effort and expense to hire a public relations firm, Marx Layne, to publicize the bankruptcy filing. (Tr. of Dec. 18, 2002, hr'g at 109.) For that purpose, Marx Layne contacted three newspapers, the Detroit News, the Detroit Free Press and Crain's Detroit Business. On June 25, 2002, the day after the involuntary petition was filed, a Marx Layne representative sent separate email messages to reporters for the Detroit News and the Detroit Free Press, apparently following up on conversations concerning the filing. (Exs. 18 and 19.) Each message vaguely referred to "payoffs" by JRH to its creditors, apparently to keep them from joining in the petition, but noted, "The payoffs won't do any good, because as of yesterday, Adell's new lawyer, ArnieSchaefer [sic] (248)-5540- 3340[sic] filed Ch. 7 in U.S. Bankruptcy Court against John Richards Homes."

Each message also attached a list of nine JRH customers whose contracts JRH had allegedly not fulfilled and outrageously stated that a state court hearing then scheduled for the following Wednesday "is sure to be worthy of coverage with plots and subplots and high profile business people coming to the surface." In an attempt to maximize

the probability of news coverage, each message falsely stated that the recipient was the only reporter in the area with this information. Finally, each message stated, "We would appreciate you keeping our name out of any conversations regarding this high-profile story."

On July 1, 2002, Marx Layne faxed a copy of the petition to a reporter with Crain's Detroit Business, along with the same list of nine JRH customers. (Ex. 15.) Crain's publicized the involuntary filing. (Tr. of Dec. 18, 2002, hr'g at 105.)

At the hearing, Michael Layne, a partner at Marx Layne, testified that Adell told him directly what he wished to be done in connection with the engagement, that Adell provided the information about the "payoffs," that Adell's secretary, Tricia St. Andre, provided the list of JRH customers, and that the messages were for the purpose of obtaining newspaper reporting of the involuntary proceedings. (*Id.* at 112-13.) On cross examination, Layne also testified that Adell did not hire the firm simply to handle media inquiries. (*Id.* at 120.) Layne further testified that Adell stated that he was concerned about JRH's trade creditors. (*Id.* at 119.)

It is also noteworthy that at the hearing, two of JRH's customers on the list of nine customers stated to be dissatisfied with JRH, Jean McIntyre and Larry Gainer, testified that they were in fact satisfied with JRH's work. (Tr. of Jan. 14, 2003, hr'g at 144-49.)

3. On May, 31, 2002, attorney Dlugokinski, representing Adell, sent a letter to Shekerjian outrageously threatening *criminal prosecution* by "the Michigan Attorney General's

Office, the Oakland County Prosecutor's Office and/or the Federal Bureau of Investigation and other federal and state agencies and departments having jurisdiction[,]" unless Shekerjian agreed to remove any mortgages and liens on the property, to cancel any debt owing by Adell, and to make restitution and pay damages. (Ex. 9.) Dlugokinski made a similar threat during the parties' meeting on June 3, 2002. (Tr. of Dec. 18, 2002, hr'g at 41.)

4. Adell's involuntary bankruptcy petition alleged that JRH owed him $800,000 for fraud and breach of contract. (Ex. 4.) However, Adell was unable to articulate how that amount was calculated.

5. Adell used improper threats and flaunted his wealth in an attempt to solicit creditors to join his petition. Two such creditors testified. Cynthia Weaver, credit manager of E.W. Kitchens, testified that Adell called her and stated that he was a very rich man, that he was angry and that he was trying to force JRH into bankruptcy. He then stated that he was looking for creditors to sign with him for the bankruptcy and that if she wanted to be paid, that would be the only way. He told her that he owned Novi Expo Center, a TV network and a couple of TV stations, and that it would not cost her anything to join in the bankruptcy petition. Adell then encouraged her to call his attorneys. She called attorney Michelle Didorosi at Carson Fischer, who verified Adell's statements.

Robert Clark of Motor City Stone, an excavating company testified that Adell called him twice to get him to sign on the bankruptcy petition. In the first call, Adell told

him that only people who signed on would be paid. The second call, Adell threatened that he would see that people who did not sign on would not be paid.

Again, Adell denied these statements. (Tr. of Jan. 14, 2003, hr'g at 9-10, 14.) However, the Court concludes that Adell's denials lack credibility.

Adell told Shekejian directly that he was worth $700 million and that he wanted his brother in law to finish the house. (Tr. of Dec. 18, 2002, hr'g at 222-24.) After their dispute surfaced, Adell also told Shekerjian that when the City of Franklin Hills had given him a hard time about certain permits required for a home that he wanted to build there, this made him mad, so he built "the ugliest home he could possibly think of just to piss them off." (Tr. of Dec. 18, 2002, hr'g at 229.) Shakerjian took this to mean that Adell was willing and able to spend significant money just to get back at someone who made him mad and he found it "scary." (*Id.*)

6. Adell's testimony that he filed the petition in reliance on the advice of experienced bankruptcy attorneys and therefore in good faith must be rejected. The record certainly establishes that Adell's counsel did some substantial investigation before concluding that an involuntary petition would be proper. Attorney Max Newman of Schafer and Weiner, the law firm that filed the petition for Adell, testified that in the ten days before the petition was filed, he twice discussed with Adell the nature and circumstances of his claims against JRH. Newman testified:

> First and most importantly, we met with our client regarding the elements of an involuntary bankruptcy petition. We spoke with him about whether there was a disputed claim as well as about the status of the entity John Richards Homes Builders, L.L.C., itself. We—I had two meetings prior to the involuntary at least with Mr. Adell where we went into the issue of whether or not the claim was disputed, and I believe specifically the question I asked him was, is there a portion of the claim over $12,000 that John Richards Homes Builders would admit. Mr. Adell and Mr. Lametti advised me that there was a portion of the claim that would be admitted.

(*Id.* at 95.)

Newman further testified that he also confirmed with Dlugokinski, who had filed Adell's state court suit against JRH, that JRH would admit a claim over $12,000. (*Id.* at 96-7.) When Newman was asked about the $800,000 claim amount stated in the involuntary petition, he testified, "The portion that was always discussed as undisputed was a lower amount, in the $130,000 range, which related to construction draws made where no construction was performed." (*Id.* at 100.)

Finally, Newman recounted a meeting with Adell and attorney Lametti just before the petition was filed. He stated,

> And I specifically again went over the disputed—potentially disputed claim issue, and I think it was

> specifically at that point I asked both of them to assure me again that there was a dollar amount that John Richards Homes Builders, L.L.C., would admit that exceeded $12,000. I believe that I advised them words to the effect that it would be a big problem if there was not.

(*Id.* at 100-01.)

Newman's testimony is significant in three distinct respects. First, Newman specifically advised Adell of the critical importance of establishing an undisputed claim over $12,000. Second, Newman advised Adell that if JRH did dispute his claim, "there would be a big problem." (*Id.*) Third, when Newman determined that JRH would admit a claim in the range of $130,000, he relied solely on assurances from Adell and Adell's attorneys.

The difficulty here is that those assurances were false and Adell and his attorneys knew it. They withheld from Newman significant information that plainly would have, or should have, made a difference on the critical issue of whether JRH either "admitted," or at least did not dispute, any portion of Adell's claim. Specifically, Newman testified to three items that neither Adell nor his attorneys provided. The first was Morris's letter of June 5, 2002, to Dlugokinski (Ex. 11), in which Morris clearly took the position that Adell had explicitly agreed to the purchase price of $1,750,000 for the real property and that it was Adell, not JRH, that was in breach of the construction contract. (Tr. of Jan. 14, 2003, hr'g at 103.) The second was another letter that Morris sent to Dlugokinski on June 5, 2002, (Ex. 10) in which Morris

demanded that Adell cease disparaging JRH and cease soliciting creditors for an involuntary bankruptcy petition. Morris also threatened "severe sanctions for damages in the event it files a frivolous petition for bankruptcy." (Tr. of Jan. 14, 2003, hr'g at 104.) Third, and most inexplicably of all, Adell and his state court attorneys never gave Newman's firm a copy of JRH's answer to Adell's state court complaint or JRH's counterclaim. (*Id.* at 105.)

It is fundamental that a client reasonably relies on an attorney's advice only when the client provides to the attorney all of the pertinent facts in the client's possession. *See United States v. United Med. & Surgical Supply Corp.*, 989 F.2d 1390, 1404 (4th Cir. 1993) (One who willfully avoids the duty to disclose all material facts cannot rely in good faith on the advice of counsel.); *C.E. Carlson, Inc. v. SEC*, 859 F.2d 1429, 1436 (10th Cir. 1988) (Full disclosure to professional must be established to support a defense of reliance.); *United States v. Eisenstein*, 731 F.2d 1540, 1543 (11th Cir. 1984) ("In order to take advantage of [the defense of good faith reliance on the advice of counsel], the defendant must show that he relied in good faith after first making a full disclosure of all facts that are relevant to the advice for which he consulted the attorney.").

Here, Adell did not make a full disclosure, and apparently deliberately so. Newman's advice that an involuntary petition would be proper was based on Adell's assurance that JRH would admit a claim of at least $12,000. However, as found above, Adell knew that JRH would vigorously dispute his claim and therefore that this assurance was false. Moreover, Newman certainly would have determined that the assurance

was false if only Adell had not withheld pertinent facts and documents. Accordingly, Adell's defense of reliance on counsel must be rejected.

Indeed, Adell's conduct in deliberately withholding evidence from his bankruptcy counsel is further evidence of his bad faith in causing the involuntary petition to be filed.

7. Adell falsely testified that in filing the involuntary petition, he was motivated by a concern for JRH's trade creditors. If he were indeed so charitably motivated, he would not have threatened at least two creditors that the only way they would be paid would be to join in the petition.

The totality of the circumstances compels the conclusion that Adell did not honestly believe that the involuntary bankruptcy petition would be appropriate. Adell did not file this petition in a sincere and honest belief that he was entitled to bankruptcy relief against JRH. Rather, he proceeded with the wrongful intent to intimidate Shekerjian into a settlement and, when that failed, to damage or destroy his business. This involuntary bankruptcy petition was not filed in good faith.

IV.

The Court concludes that because Adell did not file this petition in good faith, JRH should be awarded compensatory damages. 11 U.S.C. § 303(i)(2)(A) Such an award should be fashioned to compensate JRH for its damages, calculable with a reasonable degree of certainty, proximately caused by the improper filing. *See Glannon v. Carpenter* (*In re Glannon*), 245 B.R. 882, 896 (D.Kan.2000); *In re Landmark Distr., Inc.*,

189 B.R. 290, 315-16 (Bankr.D.N.J. 1995); *Sjostedt v. Salmon (In re Salmon)*, 128 B.R. 313, 316 (Bankr. M.D.Fla. 1991).

JRH seeks an award of compensatory damages for lost profits.

Shekerjian credibly testified that the ability of JRH to compete in the market for high end homes is critically affected by its reputation. (Tr. of Dec. 18, 2002, hr'g at 200-01.) He further stated that in the five years preceding the filing his entities had built and sold 40 homes costing over $1 million each. (*Id.* at 194.) However, since the involuntary was filed, JRH has not contracted with a single customer because of the damage to JRH's reputation that the filing caused. (*Id.* at 195-96.) He also stated that two pending sales were lost as a result of the filing. In his experience, the market for homes in this price range is not impacted by the downturn in the economy or by the tragic events of September 11, 2001. (*Id.*) Since then, other builders have obtained significant numbers of permits to build homes in this geographic and price market. (*Id.* at 209.)

JRH presented the testimony of Thomas Frazee on the issue of damages. Frazee is a certified public accountant specializing in litigation support. He concluded that JRH had incurred damages for lost profits of $4.1 million as a result of the bankruptcy filing, conservatively calculated. (*Id.* at 139.) This calculation assumes that the filing will have impact on JRH's business for five years; that JRH's future profit margins would be consistent with its historical profit margin of 17%; that JRH will achieve future homes sales prices consistent with the historical average of $1.9 million

(calculated after a couple of very high priced homes were removed); that during the next five years, JRH would lose half of its historical average of eight homes per year; and that JRH lost two of its pending sales due to the bankruptcy filing. (*Id.* at 139-48.) He also stated that the calculation was discounted to determine the present value of future lost profits. (*Id.* at 134.)

Regarding compensatory damages, Shekerjian testified that it was reasonable for Frazee to base his calculations on a historical average sales price of $1.9 million and a historical average profit margin of 17%. (*Id.* at 202-03.) He stated however that Frazee's assumption that JRH's reputation would be restored in five years was unreasonable, since in his judgment it will take much longer. Thus, this assumption resulted in a conservative calculation of JRH's lost profits. He also concluded that Frazee's assumption that JRH will be able to contract for half of its historical 7—8 homes per year on average is also conservative in light of JRH's inability to contract with any customers since the bankruptcy filing. (*Id.* at 204-05.) Therefore, he concluded that Frazee's estimate of lost profits damages of $4.1 million is conservative.

The Court finds that Frazee's calculation of lost profits and the assumptions on which that calculation is based are entirely reasonable. Frazee testified with credibility. His expertise and methodology were not undermined in any substantial way. His assumptions were supported by other credible evidence. His calculation of JRH's damages is to a reasonable degree of certainty in the circumstances. Any lingering uncertainty about the calculation of lost profits

is a result of Adell's own conduct in filing the improper bankruptcy petition and thus must not be permitted to prejudice JRH. The Court finds that JRH is entitled to an award of compensatory damages in the amount of $4,100,000.00.

V.

A.

In determining whether to grant an award of punitive damages for a bad faith involuntary bankruptcy petition, the court in *In re K.P. Enter.*, 135 B.R. 174 (Bankr. D.Me. 1992), stated:

> The purposes for assessing punitive damages are to punish the wrongdoer, to deter him from repeating his misdeeds, and to set an example so that others will be dissuaded from engaging in such conduct. Under § 303(i), the inquiry invokes a federal standard, requiring the court to exercise its discretion in a manner that will discourage misuse of the bankruptcy process, without discouraging resort to it in appropriate circumstances. If punitive damages are called for, the award must be carefully tailored in light of other damages and fees awarded in the case, so that the result implements bankruptcy policy, but is not "unduly harsh."

Id. at 183-84 (citations omitted).

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Likewise, in *In re Silverman*, 230 B.R. 46 (Bankr. D.N.J. 1998), the court explained:

> Examination of the many cases addressing imposition of punitive damages under section 303(i)(2) reveals that the factors which support a finding of bad faith also justify imposition of punitive damages. Although punitive damages are not automatically imposed upon a finding of bad faith, a punitive damages award is predicated upon a finding of bad faith. Consequently, once the court has found bad faith, the court must decide whether punitive damages are appropriate and, if so, in what amount. . . . [T]he totality of the circumstances must be considered in fashioning an appropriate award under section 303(i)(2). Therefore, although this court found that bad faith is established per se by filing an involuntary petition after denial of summary judgment in another forum, all mitigating or aggravating factors are nonetheless relevant in assessing punitive damages.
>
> In imposing punitive damages on a petitioning creditor, the dual purposes of punishment and deterrence must be effectuated. Unlike compensatory damages, punitive damages are neither measured by actual loss nor are they measured strictly in light of the impact of the creditor's bad faith on the alleged debtor. *See In re Grecian Heights Owners' Association*, 27 B.R. at 174 (Bankr. D.Or. 1982) (punitive damages

> operate as a deterrent rather than as compensation for actual loss).

Id. at 52.

"The general rule is that the amount of punitive damages must bear some reasonable relation to the injury inflicted and its cause." *In re Atlas Mach. & Iron Works, Inc.*, 190 B.R. 796, 805 (Bankr. E.D.Va. 1995). Traditionally, courts evaluate such factors as the nature and extent of the injury to the alleged debtor, the intent of the bad faith petitioners, and surrounding circumstances. *See In re Mundo Custom Homes, Inc.*, 179 B.R. 566, 571 (Bankr. N.D.Ill. 1995). *See also Atlas Mach. & Iron Works*, 190 B.R. at 805-06 (awarding $25,000 in punitive damages where faced with a "blatant attempt" to circumvent the requirements of the Bankruptcy Code); *In re Salmon*, 128 B.R. at 318-19 (awarding $250,000 in punitive damages where petitioners acted willfully and maliciously); *In re Camelot, Inc.*, 25 B.R. 861, 869 (Bankr. E.D.Tenn. 1982) (assessing $1,000 in punitive damages where petitioners "vindictively" filed their petition).

B.

This Court must also consider the pronouncements of the Supreme Court concerning the reasonableness of punitive damage awards in the context of constitutional due process and fair notice considerations. In *BMW of North America, Inc. v. Gore*, 517 U.S. 559, 116 S.Ct. 1589 (1996), the Court stated, "Punitive damages may properly be imposed to further a State's legitimate interests in punishing unlawful conduct and deterring its repetition." *Id.* at 568, 116 S.Ct. at 1595.

The Supreme Court further stated, "Perhaps the most important indicium of the reasonableness of a punitive damages award is the degree of reprehensibility of the defendant's conduct. As the Court stated nearly 150 years ago, exemplary damages imposed on a defendant should reflect 'the enormity of his offense.' " *Id.* at 575, 116 S.Ct. at 1599 (footnote and citations omitted).

Addressing a second factor to be considered, the Court stated, "The second and perhaps most commonly cited indicium of an unreasonable or excessive punitive damages award is its ratio to the actual harm inflicted on the plaintiff." *Id.* at 580, 116 S.Ct. at 1601. The Court noted that it had consistently rejected any mathematical bright line test. *Id.* at 582, 116 S.Ct. at 1602. However, the Court noted that in *Pacific Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 111 S.Ct. 1032 (1991), it approved punitive damages of more than 4 times compensatory damages. It further noted that in *TXO Prod. Corp. v. Alliance Res. Corp.*, 509 U.S. 443, 113 S.Ct. 2711 (1993), it approved punitive damages that were up to 10 times the potential damages. In *Gore*, the Supreme Court disapproved of punitive damages that were 500 times the actual damages to the plaintiff. 517 U.S. at 582, 116 S.Ct. at 1602.

Finally, the Court in *Gore* stated, "Comparing the punitive damages award and the civil or criminal penalties that could be imposed for comparable misconduct provides a third indicium of excessiveness." 517 U.S. at 583, 116 S.Ct. at 1603.

Most recently, in *State Farm Mut. Automobile Ins. Co. v. Campbell*, __ U.S. __, 123 S.Ct. 1513, 2003 WL 1791206 (April 7, 2003), the Supreme Court reiterated its holding in *Gore*. The Supreme Court

> instructed courts reviewing punitive damages to consider three guideposts: (1) the degree of reprehensibility of the defendant's misconduct; (2) the disparity between the actual or potential harm suffered by the plaintiff and the punitive damages award; and (3) the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases.

Id. at *7.

On the first consideration, the Court in *Campbell* stated, "We have instructed courts to determine the reprehensibility of a defendant by considering whether: the harm caused was physical as opposed to economic; the tortious conduct evinced an indifference to or a reckless disregard of the health or safety of others; the target of the conduct had financial vulnerability; the conduct involved repeated actions or was an isolated incident; and the harm was the result of intentional malice, trickery, or deceit, or mere accident." *Id.* at *8. The Court further explained:

> The existence of any one of these factors weighing in favor of a plaintiff may not be sufficient to sustain a punitive damages award; and the absence of all of them renders any award suspect. It should

> be presumed a plaintiff has been made whole for his injuries by compensatory damages, so punitive damages should only be awarded if the defendant's culpability, after having paid compensatory damages, is so reprehensible as to warrant the imposition of further sanctions to achieve punishment or deterrence."

Id.

Addressing the second factor, the Court in *Campbell* followed the path established in *Gore*. "We decline again to impose a bright-line ratio which a punitive damages award cannot exceed." *Id.* at *11. The Court did observe, however, "Our jurisprudence and the principles it has now established demonstrate, however, that, in practice, few awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process." *Id.* "In sum, courts must ensure that the measure of punishment is both reasonable and proportionate to the amount of harm to the plaintiff and to the general damages recovered." *Id.* at *12.

Finally, addressing the third factor, the Court in *Campbell* cautioned, "The existence of a criminal penalty does have bearing on the seriousness with which a State views the wrongful action. When used to determine the dollar amount of the award, however, the criminal penalty has less utility." *Id.* at *13.

After reviewing these factors in the circumstances presented, the Supreme Court in *Campbell* disapproved of

punitive damages that were 145 times the compensatory damages.

C.

The Court will now address the considerations appropriate in fixing punitive damages in this case. Regarding the first factor mandated by the Supreme Court, it has already been determined that the evidence of Adell's bad faith is overwhelming. He was told and knew that JRH contested his claims. He withheld crucial information from his bankruptcy attorneys. He engaged in campaign of publicity and disparagement with the specific intent to injure JRH. He threatened JRH with criminal prosecution. He flaunted his wealth. He cynically asserted a false concern for creditors. He presented no credible mitigating considerations. By any objective measure, this involuntary bankruptcy petition is an extreme case of abuse of the bankruptcy process. Adell's conduct was reprehensible and must be deterred and punished.

Regarding the second factor, it has already been determined that JRH is entitled to compensatory damages of $4,100,000. Thus, within the permissible ratio that the Supreme Court has suggested, punitive damages might be assessed up to about $41,000,000, depending on the other considerations. *Gore*, 517 U.S. at 582, 116 S.Ct. 1589; *Campbell*, 123 S.Ct. at *11.

Regarding the third factor, the Court observes that the most analogous federal crimes are false oath in a bankruptcy case under 18 U.S.C. § 152 and perjury under 18 U.S.C.

§ 1621. Conviction on these felonies can result in a fine of twice the victim's loss. 18 U.S.C. § 3571(d). *See United States v. Garrison*, 133 F.3d 831, 849 (11th Cir. 1998); *United States v. Tocco*, 135 F.3d 116, 132 (2d Cir. 1998); *United States v. Wilder*, 15 F.3d 1292, 1300-01 (5th Cir. 1994). In determining punitive damages in a civil matter, it is appropriate to consider the federal criminal fine statute, 18 U.S.C. § 3571. *Baker v. Hazelwood (In re Exxon Valdez)*, 270 F.3d 1215, 1245 (9th Cir. 2001). Nevertheless this Court is mindful of the Supreme Court's caution in *Campbell* that this consideration has "less utility." *Campbell*, 2003 WL 1791206 at *13.

The Court concludes that punitive damages of $2,000,000 are necessary and appropriate in this case. Such a punishment is approximately one-half of the compensatory damages of $4,100,00. It is approximately one twentieth of the maximum limit that Supreme Court suggests for due process purposes, here $41,000,000. It is approximately one fourth of the maximum fine for the most analogous federal crime, here $8,200,000. In the Court's judgment, this is the minimum punitive damage amount that will address the dual purposes of adequate deterrence and punishment.

One final note regarding punitive damages is necessary. During discovery, in a notice of deposition served on July 17, 2002, JRH sought information about Adell's net worth on the theory that this information would be relevant to the determination of punitive damages. However, in a motion for a protective order filed on July 31, 2002, Adell asserted that his "finances are not relevant to any issues in this dispute[,]" and that JRH's "demand for documents relating

to [his] finances is an invasion into his privacy and serves no purpose other that to harass [him]." (Adell's motion for a protective order, July 13, 2002, para. 5.) Adell further asserted that his "finances have no relevance to the measure of punitive damages even if this Court does determine that punitive damages are appropriate." (*Id.* at para. 7.) In support, Adell cited the Supreme Court's decision in *Gore*, 517 U.S. 559. After a hearing on September 9, 2002, the Court agreed with Adell that if he chose not to make an issue of his ability to pay, then his objection to discovery on this issue should be sustained on relevance grounds. Accordingly, in now determining punitive damages, the Court has acceded to Adell's request not to consider his ability to pay.

V.

Pursuant to 11 U.S.C. § 303(i)(1), counsel for JRH also seeks an award of attorneys fees of $294,941.50, plus costs of $27,851.68. In support of this request, counsel submitted a detailed fee statement.

The Court concludes that an award of reasonable fees and costs is entirely appropriate in the circumstances of this case, to make JRH whole.

Adell contends that the fee request is so outrageous that the entire request should be rejected. In the alternative, Adell argues that fees for services rendered before the petition was filed are not compensable; that the services are insufficiently detailed; that fees for duplicative services are improper; and that the hourly rates are too high.

Appendix C

The Court has reviewed the fee statement in detail and concludes that Adell's objections should be overruled, with one exception. The Court does not consider that this fee application is outrageous. Rather, it reflects a commitment to zealously and competently represent a client with a critical legal problem and to do so with extraordinary speed and diligence in order to maximize the chances of successfully defending against the petition and, ultimately, saving the business. The Court is satisfied that JRH's attorneys worked no harder or longer than necessary to defend its client's business from Adell's attack. Moreover, the Court is satisfied that there is sufficient detail in the application to determine a reasonable fee, that there was no unnecessary duplication of services, and that the hourly rates are reasonable.

The one objection that must be sustained is Adell's objection to the request for fees for pre-petition services. The Court agrees that awarding fees for such services is not proper under § 303(i)(1). *See In re Kearney*, 121 B.R. 642, 645 (Bankr. M.D.Fla. 1990). Accordingly, $9,562.50 will be deducted from counsel's fee award.

The Court awards fees and costs in favor of JRH in the amount of $313,230.68.

An appropriate order will be entered.

Steven W. Rhodes
Chief U.S. Bankruptcy Judge

Entered: April 25, 2003

Appendix C

United States Bankruptcy Court
Eastern District of Michigan
Southern Division

Case No. 02-54689
Involuntary Petition
(Dismised)

In re:
JOHN RICHARDS HOMES BUILDING CO., L.L.C.,

Debtor.

Order Regarding Alleged Debtor's Damages

For the reasons stated in the Court's opinion entered this date, it is hereby ordered that John Richards Homes Building Co., L.L.C., shall recover from Kevin Adell compensatory damages in the amount of $4,100,000; punitive damages in the amount of $2,000,000; and attorney fees and costs in the amount of $313,230.68, plus interest at the statutory rate.

s/ Steven W. Rhodes
Steven W. Rhodes
Chief U.S. Bankruptcy Judge

Entered APR 25 2003

APPENDIX D — STATUTES INVOLVED

28 U.S.C. § 703

Rule 703. Bases of Opinion Testimony by Experts

The facts or data in the particular case upon which an expert bases an opinion or inference may be those perceived by or made known to the expert at or before the hearing. If of a type reasonably relied upon by experts in the particular field in forming opinions or inferences upon the subject, the facts or data need not be admissible in evidence in order for the opinion or inference to be admitted. Facts or data that are otherwise inadmissible shall not be disclosed to the jury by the proponent of the opinion or inference unless the court determines that their probative value in assisting the jury to evaluate the expert's opinion substantially outweighs their prejudicial effect.

Appendix D

28 U.S.C. § 705

Rule 705. Disclosure of Facts or Data Underlying Expert Opinion

> The expert may testify in terms of opinion or inference and give reasons therefor without first testifying to the underlying facts or data, unless the court requires otherwise. The expert may in any event be required to disclose the underlying facts or data on cross-examination.

28 U.S.C. § 802

Rule 802. Hearsay Rule

> Hearsay is not admissible except as provided by these rules or by other rules prescribed by the Supreme Court pursuant to statutory authority or by Act of Congress.

FILED
AUG 2 - 2006
OFFICE OF THE CLERK
SUPREME COURT, U.S.

No. 05-1532

IN THE

Supreme Court of the United States

KEVIN ADELL,

Petitioner,

v.

JOHN RICHARDS HOMES BUILDING COMPANY, L.L.C.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

Should this Court grant certiorari where (i) the record in this case is that respondent's claims for damages were established factually by evidence other than hearsay testimony of an expert and (ii) the claimed conflict among the courts of appeals about the admissibility of hearsay testimony by an expert does not exist anyway?

PARTIES TO THE PROCEEDINGS AND STATEMENT PURSUANT TO RULE 29.6

The Petitioner is Kevin Adell, an individual. The Respondent is John Richards Homes Building Company, L.L.C., a limited liability company.

John Richards Homes, LLC is the sole member of John Richards Homes Building Company, LLC.

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PRELIMINARY STATEMENT

This matter arises out of the involuntary bankruptcy case of respondent John Richards Homes Building Company, LLC (JRH), which was commenced by petitioner Kevin Adell (Adell) on June 24, 2002 pursuant to section 303(b) of the Bankruptcy Code. 11 U.S.C. § 303(b). JRH was and is in the business of constructing homes.

Adell contracted with JRH to purchase land from JRH and to have JRH build his home on the land. In purchase documents, Adell swore to the accuracy of the allocation of the total price of $3,030,000 as between the land he was buying and the home JRH was building for him, Apx. 0710[1], but then later claimed that JRH had cheated him by overcharging him for the land. Apx. 0719. Before he made that claim, he had fired JRH from the job site because he professed to be angry about water which was accumulating on the property (even though the property was easily dewatered and there was nothing unusual about the water accumulation) and told JRH that he was going to have his brother-in-law build his home for him instead. Apx. 0652-0654. He sued JRH and its principal in state court, claiming that he had been cheated (Apx. 0719); JRH denied the allegations of liability in an answer (Apx. 0747) and countersued for breach of contract in state court (Apx. 0765); and then, after JRH had both filed an answer denying liability in that state court proceeding and counterclaimed against Adell for breach of contract, Adell filed an involuntary bankruptcy petition, attesting under penalty of perjury that he had an undisputed debt of $800,000 which was owed to him by JRH. Apx. 0028.

On a highly factual record, the Bankruptcy Court, in an opinion reported at 291 B.R. 727, found, among other things, that Adell — who told JRH's principal that he was worth

1. References to (Apx. __) are to the Appendix filed in the Sixth Circuit.

hundreds of millions of dollars and that he had once been given a hard time by a village in which he wanted to build a home, so that he built "the ugliest home he could possibly think of just to piss them off," Apx. 0661, 291 B.R. at 733 — (a) specifically filed his involuntary petition for the purpose of harming JRH's reputation, asking JRH's principal and counsel, at a pre-petition filing meeting, "Can the company take the hit to its reputation if an involuntary bankruptcy [is] filed?", 291 B.R. at 732, Apx. 0469-0470; (b) hired a publicist, who contacted the major Detroit area media, to publicize the bankruptcy filing, 291 B.R. at 732, Apx. 0820, 0834, 0836 — this before the Court had even determined, as 11 U.S.C. § 303 contemplates will take place after a hearing, whether the case was even suitable for involuntary bankruptcy treatment;[2] (c) provided false information to the publicist that JRH had provided "payoffs" to creditors to avoid the filing of the petition, which was repeated by the publicist to the media, 291 B.R. at 732, Apx. 0834, 0836; (d) gave the publicist the names of nine customers whom he falsely claimed were dissatisfied with JRH's work for newspapers to contact, 291 B.R. at 732, Apx. 0834, 0836, two of whom testified at trial that they were not in any way dissatisfied (and none of whom testified that they were), 291 B.R. at 732, Apx. 0984-0989; (e) threatened criminal prosecution of JRH in a letter written by his counsel if JRH did not refund his money in full, plus discharge the mortgage on his property and pay his attorney fees, 291 B.R. at 733, Apx. 0813; (f) boasted of being worth hundreds of millions of dollars and of being a very rich man, 291 B.R. at 733, Apx. 0499, Apx. 0656; (g) threatened a trade creditor of JRH, Robert Clark, that if he did not join in the involuntary petition, he would see to it that the trade creditor would not be paid, 291 B.R. at 733, Apx.

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2. *See* 11 U.S.C. § 303(h)("after trial, the court shall order relief against the debtor in an involuntary case under the chapter ...").

0527-0528 — a violation of 18 U.S.C. § 152; (h) told another trade creditor of JRH, Cynthia Weaver of EW Kitchens, that if she joined in the involuntary filing, it would not cost her anything to do so, 291 B.R. at 733, Apx. 0500 — another violation of 18 U.S.C. § 152, (i) concealed from the bankruptcy lawyers who filed his involuntary petition at his request that JRH had, in state court, already filed an answer denying the material allegations of liability and had filed a counterclaim for breach of contract, 291 B.R. at 734, Apx. 0945, instead insisting — as he swore in his petition — that the debt was undisputed, and concealed from those bankruptcy lawyers that JRH's counsel had written Adell's other lawyer who had threatened JRH with criminal prosecution that the claimed debt was hotly disputed and that the effect of filing the involuntary bankruptcy petition would be severely to harm JRH's business, 291 B.R. at 734, Apx. 0944, Apx. 0815, Apx. 0817, Apx. 0819; and (j) falsely testified that he filed his involuntary petition out of concern for creditors — at least one of whom he threatened that he would make sure would not be paid if the creditor did not join in the petition.

The evidence regarding JRH's damages was equally fact-intensive. JRH offered testimony of John Shekerjian, the principal of JRH; David Johnson, a longtime builder of super-lux homes in the metropolitan Detroit market; and Thomas Frazee, a financial analyst and expert. All testified that the filing of the bankruptcy petition had harmed JRH's ability to sell homes in a dramatic way. Contrary to Adell's claim in his petition that JRH's damages were based solely on Frazee's expert testimony, the Bankruptcy Court found as a matter of fact that Frazee's conclusions "were supported by other credible evidence." 291 B.R. at 736. In particular, Shekerjian had personally reviewed and agreed with Frazee's calculations and

conclusions as to the damages JRH's business would suffer for five years by virtue of the filing of the petition (indeed, he believed they were conservative, Apx. 0634-0640); that JRH would lose approximately half of its home sales because of the harm to reputation associated with the involuntary bankruptcy filing; and that the profit margin on lost future sales would be 17%, which was consistent with the historical experience of JRH and its affiliates, Apx. 0635).

Shekerjian, who had been in the real estate business for approximately 20 years (Apx. 0623) and was thus qualified to have personal knowledge to testify about the margins that had been enjoyed historically and what the future would hold, testified that JRH had been created as the entity to sell high-end homes (with a price point north of $1,000,000) in January, 2001, Apx. 0623; that prior to that time, homes of this type had been sold by a number of affiliates of JRH, but that the decision had been made to concentrate sales of these homes in one company because the marketing of these homes is different from homes at other price points, Apx. 0624-0625; that the affiliated entities had sold approximately 40 homes at this price point in the five years prior to his testimony, Apx. 0626; that neither JRH nor any other affiliated entity had made a home sale in this price range since the filing of the involuntary bankruptcy petition, 291 B.R. at 735, Apx. 0627; that this was so because reputation is paramount to customers building these kinds of homes, and no one wants to purchase a home from an entity that might be going out of business because of bankruptcy, 291 B.R. at 735, Apx. 0632-0633; that there were two specified, identified customers who were in the middle of negotiations to purchase homes who broke off negotiations, one of whom cited the filing as his reason, 291 B.R. at 735, Apx. 0628-0631; that the anticipated profit margin for the sale of the particular homes calculated by Mr. Frazee was consistent with his personal

understanding of what the margins would have been, and that JRH had provided Frazee with the anticipated budgets for the homes to do these calculations, Apx. 0631; that Mr. Frazee's methodology of using the volume of sales of JRH's affiliated entities was a reasonable means of calculating what JRH's sales would have been in the future but for the filing of the petition — indeed, Mr. Shekerjian said he would know of no other way of doing so, Apx. 0634; that the 17 percent margin which Mr. Frazee calculated would have been earned on lost future sales was consistent with Mr. Shekerjian's own experience in dealing with these kinds of home sales and reasonable to predict what would have happened in the future but for the filing because it was based on "historical information," Apx. 0635; that Mr. Shekerjian's conclusion that Mr. Frazee's analysis was correct was informed by "20 years in the business and understanding what our margins would be," Apx. 0635; and that Mr. Frazee's calculation that home sales would be affected for only five years and that only half of home sales would be lost was actually extremely conservative. Apx. 0636-0639.[3]

Thus, the fundamental claim of this petition — that "JRH did not offer any fact witness to establish the existence of any historical sales or profits," petition, p. 2 (a fulcrum to its argument that the only evidence of sales and profits was inadmissible hearsay, and that there is a split of authority in the circuits on whether inadmissible hearsay can be used to establish an expert opinion) — is not true. It is simply not true, as the petition asserts, that JRH's expert Mr. Frazee "simply performed

3. While Adell makes the facile claim that JRH received huge damages for each day it was in bankruptcy, "an improper petition leaves a permanent scar, even if promptly dismissed," *In re: SBA Factors of Miami, Inc.*; 13 B.R. 99, 101 (Bankr. S.D. Fla. 1991); and, as the legislative history in S. Rep. No. 95-989 at 33 (1978) explains, "[a]n involuntary petition may put a debtor out of business if it is without foundation and later dismissed."

calculations based upon uncorroborated sale and profit information given to him by JRH," petition, p. 2. To the contrary, Mr. Shekerjian expressly described the information that was provided to JRH by Mr. Frazee as "historical information." Apx. 0635. Mr. Shekerjian expressly confirmed that the calculation of a profit margin of 17% by Mr. Frazee for future sales was consistent with his own past experience in dealing with these kinds of homes and reasonable in terms of predicting what the profit margin would have been on future lost sales precisely because it was based on "historical information," Apx. 0635; that conclusion was confirmed both by Mr. Shekerjian's 20 years of experience in the business and Mr. Shekerjian's own "understanding" of the profit margins. Apx. 0635. As a matter of fact, what Mr. Frazee did here is rather like what experts typically do. He took the historical documentation generated by JRH and arrived at his own calculation of an average profit margin and average sale price of the homes, 291 B.R. at 736, Apx. 0566-0568, Apx. 0576-0579, Apx. 0618; and then Mr. Shekerjian attested from personal knowledge that these calculations were both historically accurate and that Mr. Frazee's projection of loss of half the sales of historical margins and an average price of $1.9 million was a reasonable and indeed conservative predictor of what would happen in the marketplace. Mr. Frazee specifically took historical experience of affiliates of JRH in the pre-January, 2001 time frame (remember that JRH had been created in January, 2001 as part of an overall reorganization of the affiliated entities to concentrate sales of $1 million-plus houses); he concluded that using that experience was pertinent to establish lost future profits of JRH because JRH was using the same personnel and the same vendors and incurring the same overhead as the various affiliates had for those prior sales, Apx. 0566-0568, Apx. 0576-0579. Mr. Frazee reviewed "the cost data" and "revenue numbers" for all the affiliated entities that built houses at a price point north of

$1,000,000 as part of the documents he examined. He reviewed "a great deal of additional detail" and "detailed … cost sheets, which essentially laid out the estimated costs for the construction of homes that were constructed." Apx. 0593. He looked at the "actual costs, job costs" for each of the deals that were part of his analysis. Apx. 0616. He confirmed, in response to counsel's question, that he "analyze[d] and t[oo]k into account each and every single item of variable cost that was associated with the construction of each and every one of those homes. Apx. 0619. After he did that, Mr. Shekerjian, based on his personal experience, verified that Mr. Frazee had used historical information and validated that the profit margin on future sales was consistent with his own experience as to past profit margin, and an accurate predictor of what the future would be — indeed, Mr. Shekerjian believed it to be conservative. Apx. 0634-0639. "Perhaps the best evidence of lost profits is a comparison of the experience of plaintiff's own business before and after the interruption of its progress by the wrongful act of defendant. It has never been seriously suggested that this evidence is inadmissible to prove lost profits." I Robert L. Dunn, Recovery of Damages for Lost Profits Cases (6th ed. 2005), §5.7, p. 430. For his own part, to inform himself in his analysis, Mr. Frazee examined, among other things, as he testified, financial statements for JRH, Apx. 0566; individual profit and loss calculation documents for homes constructed by affiliates of JRH over the past five years, Apx. 0566, documents which showed Mr. Frazee the revenue that was generated, the income that was received by the company and all the costs that were associated with it. Apx. 0619. Mr. Frazee looked at market data in the area serviced by JRH, Apx. 0566-0567; multiple listing service data which captures information on real estate transactions that were occurring in the public domain, Apx. 0567; data relating to permits and housing starts at the million dollar price point in which JRH operated, Apx. 0567, and data prepared by publicly traded companies in the construction

business and filed with the SEC. Apx. 0567. Likewise, Mr. Johnson's testimony as a developer with more than 20 years experience in the market that that there had not been a downturn in the market for the sale of $1 million-plus homes was confirmed by Mr. Frazee's own personal experience. Apx. 0570.

Thus, as the Sixth Circuit concluded, "[t]he record is not as barren as Adell suggests," 439 F.3d at 262; "[Shekerjian] opined [that] Frazee's use of historical sales data from the Affiliates was a 'reasonable' predictor of JRH's potential future earnings," *id.* at 263. Shekerjian testified factually that a 50% reduction in sales over the next five years was reasonable and, if anything, conservative, given the nature of the high-end home business, because (i) the filing of the involuntary bankruptcy petition was something that people would not forget, (ii) Frazee had excluded several very expensive homes from his calculation of the average price of homes sold over the previous five years, (iii) JRH had sold no homes since the bankruptcy filing, although 50 permits for high-end homes had been issued during the six-month period, (iv) high-end sales were primarily driven by the 'ripple effect' — sales lead to people talking, which leads to more sales, so any negative publicity is potentially devastating and the negative publicity in the market was quite devastating and that JRH's own plan had been to double the number of high-end homes sold per year. Apx. 0635-0640.

Allowing Mr. Shekerjian to confirm that the historical profit margins calculated by Mr. Frazee after examining voluminous records of 40 transactions involving JRH or its affiliates was perfectly permissible so long as the underlying historical documents were made available to the opposing party for examination. There was no requirement that they be actually introduced into evidence by JRH, and Adell does not even make a claim that there is some kind of circuit split on this issue. *Zayre Corp. v SM & R Co., Inc.*, 882 F.2d 1145, 1149 (7th Cir. 1989)("[t]he record reveals that Zayre did offer to make the

underlying records available at its individual stores. SM & R does not deny this but argues that such a process would have been unduly burdensome because it would have required SM & R's counsel to visit hundreds of Zayre stores to examine the records. Such a procedure might very well have been impractical. But SM & R never filed an affidavit under Fed. R. Civ. P. 56(f) requesting a continuance to pursue discovery, or a motion for a protective order under Rule 26(c), or a motion to compel discovery under Rule 37(a), or in any other way ask the district court to require Zayre to make the underlying records more conveniently available before the district court entered summary judgment. SM & R cannot now complain about the burden that inspecting the underlying records would have imposed").

Zayre's teaching is especially instructive here because, contrary to Adell's claim in his petition that the underlying documents were never produced, there was sharp factual dispute as to whether the underlying records were indeed produced so that Adell could cross-examine with respect to them; JRH contended — and its counsel who was in charge of production represented to the Court — that each and every single record which supported the calculations as to which Mr. Shekerjian and Mr. Frazee testified had been produced; some 15 boxes of documents were produced in September, 2002, months before the December hearing date. Apx. 0584. The most powerful evidence that that is so is that in the final pre-trial order entered by the Bankruptcy Court, the Bankruptcy Court had a specific section asking for the parties to identify any evidence problems likely to arise at trial. Apx. 0185. This would have been the paradigm opportunity for Adell to complain if the documents underlying the conclusion Mr. Frazee reached, validated by Mr. Shekerjian based on his own experience, had not in fact been produced. Adell did not identify the ostensible failure to produce documents — or, for that matter, any other evidence problem — in his portion of the pre-trial order. The trial court's decision

during the hearing to reject the argument that the documents had not been produced because Adell never timely identified the problem as a problem in the pretrial order and waited until the day of the hearing to move for exclusion (Apx. 0584-0585) is the precise kind of pre-trial housekeeping duty to which trial courts are entrusted.

Indeed, in his eagerness to create an issue for certiorari that does not exist, Adell actually mischaracterizes the record. Adell says in his petition that Mr. Frazee conducted no investigation to determine whether the data supplied by JRH was in fact accurate to form his conclusion, but instead says that "Shekerjian indicated that the numbers Frazee used were those that 'we gave him'." Petition at 8. In fact, as even a cursory examination of the record reveals, Mr. Shekerjian did not use the word "numbers," he used the word "number"; and the "number" to which Mr. Shekerjian was referring was the number of houses sold by JRH or its affiliates in the $1,000,000+ price point range, the records relating to which Mr. Frazee was using to reach a conclusion as to what the historical profit margin was on the sales of these homes as a basis for predicting profit margins on lost future sales, *not* the numbers at which Mr. Frazee arrived (17% profit margin; $1.9 million average sale price) after conducting this analysis. *See* Apx. 0636-0637 ("[by JRH's counsel]: Take 35 plus homes over five years, that's seven a yea[r]. He assumes, he reduces it to four. Do you think that's reasonable, conservative? What's your view, based upon your experience with the market? [by Mr. Shekerjian]: First of all, the number went down to 30 some, 35 or so. I mean the number we gave him, the actual number was higher. He excluded a few of the large ones, just to be conservative. So the average number is what it is"). An examination of the record on this point reveals just how careful Mr. Frazee's calculation was, and how he did not rely slavishly on information provided by JRH to inform his conclusion. Among the approximate 40 transactions whose financial records Mr. Frazee examined, Mr. Frazee found several

home sales where the price was extraordinarily and atypically large or there was some other reason to exclude the data from these home sales in the analysis Mr. Frazee was conducting; including, for example, a transaction where the sale price of the house was uncharacteristically large would have skewed the approximate sale price inappropriately upwards, and thus increase the dollar amount of damages in the calculation. Mr. Frazee eliminated those "transactions" precisely to make his analysis more informative and accurate. Apx. 0575.

Adell also says that two former employees of an affiliate of JRH testified that the financial condition of JRH was ostensibly deteriorating and that JRH was having difficulty paying its trade creditors. But Mr. Shekerjian testified that these employees were disgruntled ex-employees, Apx. 0972, 0973, 0977, who had been dismissed from their positions, whose testimony was not reliable; he testified that JRH's financial picture was sound and that JRH was not having difficulty paying trade creditors, Apx. 0975; one of the ex-employees, Deborah Lee Bjorkly, claimed that there were liens on houses which had been built because of these ostensible problems, but acknowledged on cross-examination that she did not know the difference between a lien and a notice of commencement, Apx. 0905; Mr. Shekerjian testified that there were no liens, Apx. 0973 (and, as JRH's counsel pointed out in the trial court below, if there were liens, they would have been matters of public record and would surely have been introduced in evidence by Adell). Mr. Shekerjian also testified that since all of the homes that were being built would have been built in the $1,000,000-plus range and would have been owner-financed, the general financial condition of JRH would have been irrelevant to whether the homes would have been built, anyway. Apx. 0976. The trial court, by expressly crediting Mr. Shekerjian's testimony on these points, implicitly rejected — as the trial court, as the observer of the credibility of the witnesses was entitled to do — Bjorkly's and Seklar's contrary testimony.

OPINIONS BELOW

The Bankruptcy Court's decision after trial awarding JRH $6,413,230.68 in compensatory and punitive damages is reported at 291 B.R. 727. The District Court's decision affirming the Bankruptcy Court's decision and awarding JRH costs is reported at 312 B.R. 849. The Sixth Circuit's decision affirming the Bankruptcy Court's and District Court's rulings is reported at 439 F.3d 248. Adell did not seek rehearing, either before the panel which rendered the decision or en banc.

After the Bankruptcy Court issued its award, Adell, within ten days of entry of the award, liquidated Michigan assets he owned and funneled them into a Florida mansion, and then sought to invoke the benefit of Florida's homestead exemption. The Bankruptcy Court concluded that Adell was not a bona fide citizen of Florida and found further that 11 U.S.C. § 303(i) would have preempted the Florida homestead exemption even if Adell were a bona fide Florida citizen to the extent that the homestead exemption was interpreted to allow a defendant required by federal law to pay an award for abuse of the involuntary bankruptcy process to avoid paying the federal award by the expedient of changing domicile and shielding his assets in a homestead, and ordered Adell to sell the Florida house he had purchased and remit the proceeds to JRH. 298 B.R. 591. While Adell appealed this decision, he did not pursue the appeal; and Adell has now paid the award in full, with interest, which Adell did by tendering funds to the registry of the Bankruptcy Court in March, 2006.

After the Bankruptcy Court issued its order, Adell filed a voluntary Chapter 11 bankruptcy petition on his own behalf in November, 2003. Eventually Adell's Chapter 11 petition was dismissed by the Florida District Court, on appeal from the Florida Bankruptcy Court, after Adell proffered five plans of reorganization. The District Court found that the Bankruptcy

Court had erred in essentially finding that Adell had filed his petition in bad faith but not dismissing Adell's petition. Adell appealed the dismissal of his case to the Eleventh Circuit, which dismissed his appeal. These decisions are not reported. Adell has not sought certiorari to this Court from that dismissal. Adell also purported to convert his dismissed Chapter 11 case to a Chapter 7 filing, even though the linchpin of the District Court's decision was that bad faith had motivated his filing. The Florida Bankruptcy Court dismissed Adell's Chapter 7 filing; Adell appealed to the Eleventh Circuit; the Eleventh Circuit denied Adell's emergency motion for stay pending appeal; and then Adell dismissed his appeal.

Adell sought a stay pending appeal of the Bankruptcy Court's award. The District Court denied the motion for stay pending appeal notwithstanding Adell's proffered willingness to post a supersedeas bond, finding that the award was governed by Bankruptcy Rule 8017, which entrusts a stay to the discretion of the court rather than providing a stay as a matter of right upon the posting of a supersedeas bond, because "Mr. Adell's past and present manipulations of the judicial system are inimical to the public interest and continue to exacerbate JRH's injury by making recovery unjustifiably expensive and prolonged." 320 B.R. 139, 142. The Sixth Circuit also denied Adell's motion for stay pending appeal (filed by Adell because once his invocation of voluntary bankruptcy had been rejected, he could no longer claim the benefit of the automatic stay). This November 1, 2005 decision of the Sixth Circuit is not reported. Adell then filed an emergency motion for stay with this Court while the Sixth Circuit had the appeal of the Bankruptcy Court's and District Court's decisions under advisement. That motion was denied by Justice John Paul Stevens; the decision is not reported.

JRH argued to the Sixth Circuit that this post-award conduct of Adell — including, among other things, liquidating his assets to avoid paying the award, and representing to the Florida Bankruptcy Court that his appeal in the Sixth Circuit was being expedited (this to deflect the Bankruptcy Court's query whether Adell was simply not dragging out the proceedings) and thereafter opposing JRH's motion to expedite the appeal) — was an independent basis for affirming the Bankruptcy Court's and District Court's decisions. Because the Sixth Circuit affirmed on the merits, it did not consider this issue.

STATEMENT

A. *Background.*

On December 28, 2001, Adell and JRH entered into a contract for the construction of a home and sale of land to Adell (on which the home would be located) in Bloomfield Hills, Michigan for $3,030,000. Apx. 0825. In January and February 2002, Adell financed the purchase. He swore to the accuracy of the allocation that had been made in closing papers as to the respective value of the land which was being purchased ($1,750,000) and the home which was being built (the balance). Much of this amount was used to purchase the land. Apx. 0710. JRH's principal John Shekerjian testified that a certain amount of the money was held in trust for Adell to be used in connection with construction of the home, and denied that the money was not in fact held in trust. Apx. 0246-0247. JRH began preparing the property for construction. The property experienced a not-uncommon water problem — a hole was dug for excavation, and it filled with water — but JRH had dewatering take place and this problem was solved. But Adell expressed dissatisfaction with the progress which was being made on constructing the property; he fired JRH from the job site; he told JRH that his brother-in-law was going to build the house; and he claimed that JRH had cheated him by overcharging him for the land,

even though he had previously sworn to the accuracy of the allocation. Apx. 0653-0654. Adell also had a lawyer write a letter on May 31, 2002, threatening JRH with criminal prosecution and demanding that JRH refund Adell all of the money that Adell had paid to JRH, and eliminate the mortgage on the property which Adell had taken, and pay JRH his costs and attorney fees. Apx. 0813.

B. ***Events Leading to the Involuntary Bankruptcy Case.***

After receiving the threat, JRH and its counsel, E. Michael Morris, asked for a meeting, which was attended by, among others, Adell and the lawyer who had threatened JRH with criminal prosecution. Adell pointedly asked John Shekerjian, JRH's principal, whether JRH could take the hit to its reputation which would be associated with the filing of a bankruptcy petition and repeated the threats in the letter. Apx. 0473, Apx. 0471. At this meeting and in subsequent correspondence, JRH and its counsel specifically denied that Adell had been overcharged for the land and pointed out that comparable land sales were consistent with the price to which Adell had agreed (in fact, JRH had invested more than the $1,750,000 sale price of the land in the land); specifically disputed liability to Adell; and specifically warned Adell that an involuntary bankruptcy petition would be precipitous, improper and would work vast harm to JRH, for which JRH would seek suitable redress. Apx. 0471-0472; Apx. 0817, 0818, 0819. Adell filed a state court lawsuit after this meeting, accusing JRH and Mr. Shekerjian of fraud and asserting other claims. Apx. 0719. Prior to the filing of the involuntary bankruptcy petition, JRH and Mr. Shekerjian answered the state court complaint; denied the material allegations of liability; and counterclaimed against Adell for breaching the contract to buy the land and home. Apx. 0747-0765.

C. *The Proceedings Below.*

1. The involuntary bankruptcy case.

On June 24, 2002, Adell commenced the involuntary bankruptcy case against JRH under Chapter 7 of the Bankruptcy Code, 11 U.S.C. § 301 *et seq*. JRH moved to dismiss the involuntary case on July 1, 2002. The Bankruptcy Court set a hearing on the motion for July 15, 2002. Before the Bankruptcy Court conducted its hearing on July 15, 2002 to determine whether the case was even suitable for treatment as an involuntary bankruptcy matter, Adell (a) threatened one trade creditor that if he did not join the involuntary bankruptcy petition, Adell would see to it that he was not paid what he was owed; (b) promised another trade creditor that if she joined in the petition, she would not have to pay anything; (c) boasted to those creditors variously that he was very wealthy and owned a television station and an exposition center; and (d) gave false information to a publicist he hired for the express purpose of publicizing the involuntary filing, including providing the names of nine ostensibly dissatisfied customers of JRH whom he asked the publicist to have the media contact and telling the publicist that JRH had given payoffs to trade creditors to try to forestall the filing. The filing was reported in the local media. Adell's publicist falsely told each media representative that it had an "exclusive" story on its hands. Apx. 0527-0528; Apx. 0500; Apx. 0834; Apx. 0836; Apx. 0984-0989.

On July 15, 2002, the Bankruptcy Court dismissed the involuntary bankruptcy petition. Adell never appealed the dismissal.

2. Proceedings under 11 U.S.C. § 303(i).

11 U.S.C. § 303(i) contemplates that after dismissal of an involuntary bankruptcy petition, the Court retains jurisdiction to conduct hearings to determine whether an award of attorney

fees and costs, compensatory and punitive damages is available. Attorney fees and costs are awardable regardless of whether the dismissed petition was filed in good faith; compensatory and punitive damages are awardable if a filing is made in bad faith.

Following discovery, the Court conducted a hearing on JRH's claim of entitlement to compensatory and punitive damages and attorney fees and costs in December, 2002 and January, 2003. John Shekerjian testified about Adell's threats; about the harm that JRH had suffered and would in the future suffer because of the filing of the involuntary bankruptcy petition, and, in particular, how the filing had devastated JRH's reputation. He reviewed calculations made by Thomas Frazee, JRH's outside damages expert, he confirmed that JRH and its affiliates had historically experienced a 17% net profit margin; that Mr. Frazee's calculation of the volume of lost sales over the next five years was accurate, and, indeed, conservative as to amount; he confirmed that he had provided Mr. Frazee with historical information to allow Mr. Frazee to make his calculations; he testified that a 17% profit margin was accurate, based on his understanding and experience, in predicting the profit margin on lost future sales by JRH. Apx. 0634-0640.

David Johnson was a real estate developer who had developed residential communities, including super-lux communities, for more than 20 years in JRH's market areas. He testified that in his experience, the filing of the involuntary bankruptcy petition had definitely harmed JRH's ability to sell houses, because the very filing of an involuntary bankruptcy petition clouded the reputation of JRH and caused prospective purchasers to seek out other super-lux builders who were not affected by this taint to reputation. He testified that the market

for super-lux homes remained strong despite the impact of the downturn of the economy on sales at other price points. Apx. 0507, 0510-0511.

Robert Clark was a trade creditor of JRH who testified that he had been threatened by Adell that if he did not join the involuntary bankruptcy petition, Adell would be in charge of the distribution of assets in the bankruptcy and he would see to it that Clark would not be paid. Apx. 0527-0528.

Cynthia Weaver of EW Kitchens testified that EW was a trade creditor of JRH; that Adell identified himself as a very rich man who owned a television station and an exposition center, and told her that she could verify that this was so with Adell's lawyer; Adell's lawyer in fact verified that information in response to Weaver's request.

Michael Layne of the Marx, Layne advertising agency testified that Marx, Layne had been hired by Adell for the express purpose of publicizing the involuntary bankruptcy petition, 291 B.R. at 732, Apx. 0535; Marx, Layne in fact notified the two major Detroit newspapers and Detroit's primary business trade publication; that Marx, Layne had falsely told each of these Detroit media outlets that they were getting an "exclusive" story about the involuntary petition, presumably to maximize the prospects of coverage, Apx. 0834, 0836; that Adell had given Marx, Layne information that there were nine dissatisfied customers of JRH whom the media should contact and that Adell had told Marx, Layne that JRH had engaged in "payoffs" to forestall the filing of the involuntary bankruptcy petition, Apx. 0544-0545 (in fact, no payoffs were made).

Jean McIntyre and Larry Gainer, two of the nine ostensibly dissatisfied customers identified by Adell to his publicist Marx, Layne and, in turn, identified by Marx, Layne to the media,

testified that they were pleased with the work that JRH had done and that they had no complaints or dissatisfaction, and had no idea how Adell claimed to identify them as disgruntled or dissatisfied with JRH in some way. No customer testified to any dissatisfaction. Apx. 0984-0989.

Michael Morris, JRH's counsel, testified to the meeting that took place prior to the filing of the involuntary bankruptcy petition to the threats made by Adell and to the fact that JRH disputed liability in the meeting and in correspondence. Apx. 0469-0473.

Thomas Frazee, JRH's outside economic expert, testified that he had examined historical information of JRH and its affiliates, including documents given to him by JRH which reflected each and every cost associated with building the homes built by JRH and its affiliates over the prior five years at price points north of $1 million, to determine the average profit margin of JRH and its affiliates and average sale price of JRH and its affiliates with respect to these transactions, this to reach a conclusion on how JRH would have performed in the future with respect to sales lost as a result of the bankruptcy filing; that he excluded certain transactions as being at too high dollar a volume, which would skew the average calculations in a way that Frazee believed inappropriate; and that he had examined financial statements of JRH, had independently consulted the multiple listing service, looked at housing starts from other builders, examined public records filed with the SEC of similar builders, spoken with area brokers about market demand and verified that the housing market for houses north of the $1 million price point had not been affected by downturns in the local economy. Apx. 0566-0568; Apx. 0576-0579; Apx. 0618; Apx. 0570.

D. *The Award.*

On April 25, 2003, the Bankruptcy Court entered its award in the amount of $6.413 million in JRH's favor.

REASONS FOR DENYING THE PETITION

A. *General Rules Relating To The Grant Of Certiorari Petitions.*

As this Court held in *Layne & Bowler Corp. v. Western Well Works, Inc.*, 261 U.S. 387, 393 (1923), petitions for certiorari will only be granted "in cases involving the settlement of which is of importance to the public, as distinguished from that of the parties, and in cases where there is a real and embarrassing conflict of opinion and authority between the Circuit Courts of Appeal." In the words of Chief Justice Taft in *Magnum Import Co. v. Coty*, 262 U.S. 159, 163 (1923), certiorari jurisdiction is "not conferred upon this court merely to give the defeated party in the Circuit Court of Appeals another hearing." What is more, where a decision is dependent on a factual finding, not a ruling of law with respect to which there is disagreement among circuit courts, certiorari is inappropriate; in the absence of extraordinary circumstances, it is the "settled practice" of this Court to accept "factual determinations in which the district court and the court of appeals have concurred." *Brantl v Finkel*, 445 U.S. 507, 512 (1980).

B. *The Decision In This Case Was Highly Factually Dependent And Does Not Implicate Any Circuit Conflicts.*

Adell would have this Court conclude that there is an issue ripe for consideration on certiorari on the state of this record: whether an expert conclusion based on inadmissible hearsay documents whose content JRH ostensibly made no effort to prove, is, standing alone, enough to establish the fact that the expert has concluded. That is not what this record presents at all:

— For starters, the facts (what JRH's affiliates' historical profit margins were, what the average price of homes was historically and what future losses JRH would incur by virtue of the filing of the bankruptcy petition) were not just testified to by Mr. Frazee. Mr. Shekerjian also testified to these facts, and he was subject to full cross-examination.

— Mr. Shekerjian testified that he provided historical information to Mr. Frazee to inform Mr. Frazee's analysis, and Mr. Frazee likewise testified that he was provided with documents showing each and every item of cost and revenue which he used to perform his analysis. These documents were produced to Adell's counsel and so Adell had a full and fair opportunity to cross-examine both Mr. Shekerjian and Mr. Frazee about them. Analyzing these documents was a more than appropriate way to calculate lost future profits of JRH.

— Indeed, for that matter the expert here did not even, as the Sixth Circuit pointed out, use the underlying documents showing the historical profit margins of JRH's affiliates to prove what JRH's affiliates' profit margins on house sales were — so the expert's testimony was not even classic hearsay. They were simply used to make a prediction about what the sales price and profit margins on future lost sales of JRH.

On this highly factual record, this case does not, therefore, remotely implicate any ostensible circuit conflict on the issue of whether expert testimony based on inadmissible hearsay documents can, standing alone, establish a fact. Where a principal of a business opines as to facts and those facts are based upon a review of documents, the principal's factual conclusion is admissible so long as the underlying documents are made available for examination. *Zayre*, *supra*. Under Rule 703, the documents need not be admitted into evidence; indeed, they need not even be "admissible" in evidence, so long as they are "of a type reasonably relied upon by excerpts in the particular

field in forming opinions or inferences upon the subject." Experts rely on business records of businesses all the time in reaching their conclusions; they would in fact be admissible under the well-established exception to the hearsay rule contained in Rule 803(6); but Rule 703 makes clear that they need not even be admissible in evidence for experts to rely upon them in reaching their conclusion. *See, e.g.*, *International Adhesive Coating Company, Inc. v. Bolton Emerson International, Inc.*, 851 F.2d 540, 545 (1st Cir. 1988)("Vesey testified that he derived his damage estimates by reviewing International's business and financial records and through interviews with company personnel. We think it obvious that these are sources of information normally and reasonably relied upon by accountants ..."); *Local 159, 342, 343, 344 & 444 v. Nor-Cal Plumbing, Inc.*, 1999 U.S. App. LEXIS 17968 at *28 ("[b]ecause the district court determined that the data was of a type upon which accountants reasonably rely in forming their opinions, it did not err in permitting the experts to rely on this data in the course of their testimony or in admitting the data for the limited purpose of explaining the basis of their opinions"); *South Central Petroleum, Inc. v. Long Brothers Oil Co.*, 974 F.2d 1015, 1019 (8th Cir. 1992)("the district court expressly limited the admission to the expert's opinion and did not admit the information on which the expert based his opinion. Moreover, Long Brothers does not dispute that their opponent's expert based his opinion on information reasonably relied upon by experts in the field").

Adell simply has not, therefore, remotely demonstrated that in this highly factual context, this Court should make the "commitment of scarce judicial resources" that a grant of certiorari represents. *Oklahoma City v. Turtle*, 471 U.S. 808, 816 (1985).

C. *There Is No Conflict Among Circuits, Anyway.*

Even if this certiorari petition squarely implicated the issue of whether an expert could testify to a fact based solely on inadmissible hearsay, without more — and it simply does not on this record, which is why the petition should be denied — there is no conflict, anyway.

Adell argues that the First and Sixth Circuits have somehow split from the Fifth, Seventh, Eighth, Ninth, and Tenth Circuits on the requirements of expert testimony. Adell cites only one case in the First Circuit for this alleged split; in turn, the case at issue in this appeal is the only Sixth Circuit authority that Adell cites to demonstrate that there is a split.

Neither of these two cases in the First and Sixth Circuits represent any departure from the prevailing law of the other circuits to which Adell refers. In *International Adhesive Coating Co., Inc. v. Bolton Emerson Intern., Inc.*, 851 F.2d 540, 545 (1st Cir. 1988), an accounting expert reviewed a company's financial records and prepared a report estimating lost sales. A party attempted to argue that the expert was obligated to present "invoices, statements, documents, breakdown or … supporting data" to support the damages he testified about. *Id.* at 545. The court pointed out that such an argument ignores Federal Rule of Evidence 705, which states:

> The expert may testify in terms of opinion or inference and give reasons therefor without first testifying to the underlying facts or data, unless the court requires otherwise.

The court also noted Federal Rule of Evidence 703, which provides:

> If of a type reasonably relied upon by experts in the particular field in forming opinions or inferences upon the subject, the facts or data need not be

> admissible in evidence in order for the opinion or inference to be admitted.

In the case at bar, Mr. Frazee examined business records, which are of course of the type often relied on by experts to make conclusions. The *International Adhesive* court held that the expert's testimony "did not have to establish the validity of the central, disputed factual claims in this case in order to have a factual basis and be admissible." *Id.* at 545. In making its holding, the court stated that any issues regarding the underlying documentation went to the weight of the testimony, not its admissibility; opposing counsel had the opportunity to expose any weaknesses through cross-examination. *Id.* at 544. Subsequent opinions by the First Circuit Court of Appeals make it clear that the First Circuit did not "abandon its critical gatekeeper function in favor of admitting hearsay through expert testimony." *See Univ. of Rhode Island v. A. W. Chesterton Co.*, 2 F.3d 1200, 1218 (1st Cir. 1993)("Rules 703 and 705 do not afford automatic entitlements to proponents of expert testimony"). So the First Circuit simply did not violate the hearsay rule by allowing the expert's testimony; and, indeed, the First Circuit has made clear that a proponent of expert testimony cannot rely upon a hearsay fact to establish the truth of the fact through the expert.

The Sixth Circuit Court of Appeals followed this well-accepted approach in the case at bar. Mr. Frazee used historic sales data from the past five years to estimate future lost profits. *Id.* at 263. Adell argued that the bankruptcy court could not accept the expert's testimony without actual evidence in the record of the sales data the expert examined. *Id.* at 263. The court disagreed and held that the expert's testimony was admissible under Federal Rules of Evidence 703 and 705. *Id.* at 264. "[A]n opposing party who would challenge the facts underlying the expert's opinion must do so by cross-examination." *Id.* at 264.

This position of the First and Sixth Circuit is consistent with every other circuit in the country, including those cited by Adell. *See Robinson v. Missouri Pac. R. Co.*, 16 F.3d 1083, 1090 (10th Cir. 1994)("[t]he burden is on opposing counsel through cross-examination to explore and expose any weaknesses in the underpinnings of the expert's opinion"); *South Cent. Petroleum, Inc. v. Long Bros. Oil Co.*, 974 F.2d 1015, 1019 (8th Cir. 1992)("[a]ny weaknesses in the factual underpinnings of (the expert's) opinion go to the weight and credibility of his testimony, not to its admissibility"); *Walker v. Soo Line R. Co.*, 208 F.3d 581, 587 (7th Cir. 2000), *cert. denied*, 531 U.S. 930 (2000)(in connection with an expert opinion, "[t]he accuracy and truthfulness of the underlying [educational] history is subject to meaningful exploration on cross-examination and ultimately to jury evaluation"); *Mitchell v. Lone Star Ammunition, Inc.*, 913 F.2d 242, 252 (5th Cir. 1990)(holding that an expert opinion is admissible despite opposing counsel's argument that the expert testimony relied on hearsay); *U.S. v. Elliott*, 91 F.3d 156 (9th Cir. 1996), cert. denied, 519 U.S. 987 (1996)(holding that the government did not have to introduce report into evidence that expert relied on).

Adell misconstrues a range of cases and ignores the Federal Rules of Evidence in his attempt to manufacture a circuit split. A typical example is *Viterbo v. Dow Chem. Co.*, 826 F.2d 420 (5th Cir. 1987), which Adell claims is in direct conflict with *International Adhesive* and the Sixth Circuit's holding in this case. In *Viterbo*, an expert physician gave his opinion regarding the cause of a patient's illness. *Id.* at 423. The expert's opinion relied on the patient's oral statements that he experienced certain symptoms, but the expert failed to inquire into the patient's family history. *Id.* at 423. If he would have done so, the expert would have found a family history of depression and hypertension; the patient was also experiencing those symptoms, indicating that hereditary traits could be the cause of the illness

instead of the cause the expert named. *Id.* at 423. The expert also relied on tests which could have supported conclusions other than the one arrived at by the expert. *Id.* at 423. All that *Viterbo* held was that because the expert did not even examine medical records, conduct medical tests and had no scientific literature to back up his opinion, his testimony was of no use to the jury; the expert's testimony was simply the patient's "testimony dressed up and sanctified as the opinion of an expert." *Id.* at 424.

This does not conflict in any way with the holding of the Sixth Circuit here or the holding in *International Adhesive*. In the case at bar, Mr. Frazee did exactly what an expert is supposed to do: he used his accounting expertise to examine each and every item of cost and revenue associated with sales of JRH's affiliates to reach a conclusion as to what the average profit margin was on these historical sales and what the average sale price was for these sales, using documents of those transactions to conduct his analysis. He did not simply take Mr. Shekerjian's opinion with respect to what historical sales profit percentage and historical prices had been and wrap that opinion into an "expert" package. And *Viterbo* is not a case in which the expert testified based on records but the records were not made available for examination or admitted into evidence; to the contrary, one of the reasons why the Court excluded the doctor's expert opinion in *Viterbo* is that he examined no records at all.

Similarly, *International Adhesive* did not hold that an expert could rely upon the hearsay assertion of a fact to prove the fact just by wrapping his testimony in the mantle of "expert" opinion; nor did the Sixth Circuit in this case. Indeed, the Sixth Circuit carefully pointed out that Mr. Frazee's testimony was not used to establish what JRH's affiliates' past profits were, based on his examination of documents.

Adell likewise misconstrues the Seventh Circuit's holding in *Matter of James Wilson Assocs.*, 965 F.2d 160 (7th Cir. 1992) to create a conflict where none exists. In *James Wilson*, the value of a building was at issue in order to determine a secured creditor's interest. *Id.* at 172. In an effort to prove that the building was worth much less than a reorganization plan assumed, an expert architect planned to testify about the building's physical condition; however, the only source for the expert's knowledge was a report prepared by a consulting engineer. *Id.* at 172. The court rightly held that the expert's testimony was pure hearsay and would not be admitted. *Id.* at 173. The architect was not an engineer and the engineer — to the Seventh Circuit's puzzlement — never testified; instead, the architect purported to testify to the engineer's conclusions. The court's conclusion that this was impermissible was hardly remarkable. The *Wilson* Court did say, like the other circuit's have said, that an expert witness "is allowed to explain the facts" underlying his opinion, "even if they would not be independently admissible." *Id.* at 172-73.

The testimony of the experts in *International Adhesive* was not, as the Sixth Circuit pointed out in this case, introduced in order to prove the underlying historical sales data, *i.e.*, what JRH's affiliates had experienced. Mr. Shekerjian's testimony proved that; Adell never objected to Mr. Shekerjian's testimony, and Adell had the documents informing his conclusion to cross-examine with. The expert testimony instead was put forth in order to prove future lost profits of JRH; the experts used underlying financial data as one of many tools to determine the amount of damages. The Sixth Circuit approvingly cited *James Wilson* and acknowledged that "expert testimony may not be used to establish underlying facts not otherwise in evidence." 439 F.3d at 264. But as the Sixth Circuit stated, there was no independent need to establish the past profits of JRH's affiliates, and thus the expert's testimony was only used to demonstrate

JRH's future damages. *Id.* at 264. There was no hearsay violation and consequently no conflict among the circuits.

Adell also cites *TK-7 Corp. v. Estate of Barbouti*, 993 F.2d 722 (10th Cir. 1993). However, a review of *TK-7 Corp.* indicates that the Tenth Circuit does not disagree with the Sixth Circuit's or First Circuit's reasoning, either. In *TK-7 Corp.*, a party produced an expert to testify as to future lost profits in Great Britain. *Id.* at 730. This testimony relied on another professional's market report projecting that the company would be able to capture 5% of a certain segment of the market in Great Britain. *Id.* at 731. However, the expert had no other basis for his testimony other than these future sales projections performed by *another* expert, and admitted that he had no expertise regarding sales projections in Great Britain. *Id.* at 731, 732. The court thus excluded the expert's testimony because it simply repeated the findings of another expert. *Id.* at 732. This failure to demonstrate any independent basis for the expert opinion gave the opposing party little opportunity for meaningful cross-examination. *Id.* at 732. By contrast, here, Mr. Shekerjian confirmed the past profits of JRH's affiliates; the documents which informed Mr. Sherkerjian's conclusion were available to Adell for Adell to cross-examine; and so the Sixth Circuit did nothing in conflict with any other circuit.

Unlike *TK-7 Corp.*, the testimony of experts in *International Adhesive* and this case did not simply parrot information the experts received from someone else. The experts in both cases used financial data to do what experts do: to arrive at *independent* conclusions that were not simply read from a market report prepared by another expert. This independent analysis gave the opposing parties ample opportunity to cross-examine the testifying experts concerning the methodology used to arrive at their opinions. By the Tenth Circuit's own statement, it was a lack of opportunity to cross-examine the expert whose finding

the testifying expert parroted that distinguished *TK-7 Corp.* from the usual case where the expert's "validation, expertly performed and subject to cross-examination, ought to suffice for judicial purposes." *Id.* at 732.

The First, Sixth, Fifth, Seventh, Eighth, Ninth, and Tenth Circuits are all in agreement that an expert's testimony does not have to establish the validity of disputed claims in order to be admissible; it is only where a party uses expert testimony to establish underlying facts not otherwise in evidence that the courts bar the expert's conclusions. Thus, the authority relied on by the Sixth Circuit Court of Appeals in this case on appeal is supported by a national consensus, and does not depart from any other circuits' holdings.

CONCLUSION

The petition for a writ of certiorari should be denied.

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IN THE

Supreme Court of the United States

KEVIN ADELL,

Petitioner,

v.

JOHN RICHARDS HOMES BUILDING COMPANY, L.L.C.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

REPLY BRIEF

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REPLY BRIEF FOR PETITIONER

In its brief in opposition, JRH fails to refute Adell's demonstration of a clear circuit conflict on the question presented. JRH concedes the existence of the evidentiary rule (applied by numerous courts of appeals) that a party with the burden of proof cannot establish an essential fact through the hearsay testimony of an expert. *See* Pet. Opp. 24 ("a proponent of expert testimony cannot rely upon a hearsay fact to establish the truth of the fact through the expert"). Nevertheless, JRH attempts to avoid through evasion the reality that the decision below conflicts irreconcilably with the decisions of other courts of appeals over this very rule. Specifically, JRH attempts to conflate the question presented with the wholly different issue whether an expert may rely on hearsay in forming his or her opinion. That an expert may rely on hearsay in forming an opinion, *see* Fed. R. Evid. 703, and may disclose through testimony the hearsay that he or she relied upon in forming the opinion, *see* Fed. R. Evid. 705, does not relieve the party with the burden of proof of the obligation to establish a relevant fact through appropriate, non-hearsay evidence, *see* Fed. R. Evid. 802. JRH cannot avoid the existence of a clear circuit conflict on the question presented by purposely missing the point.

With regard to Adell's demonstration that the decision below conflicts with prior decisions of this Court and is plainly wrong, JRH says nothing at all. JRH also fails to refute Adell's demonstration that this case presents an ideal vehicle to resolve the conflict over the question presented because the conflict arises squarely in this case and resolution of the conflict is outcome-determinative. Notwithstanding JRH's efforts at obfuscation (in part through its recitation of numerous irrelevant and meritless assertions), the facts necessary to resolve this matter are undisputed (and clearly demonstrated in the record), and may be summarized succinctly as follows:

As the court below acknowledged, JRH had the burden of proving its claim for damages in the form of lost profits. Pet. App. 29a. In order to prove its clam for lost profits, JRH had to demonstrate that it *actually had* the stream of profits that it claims

it lost – i.e., if JRH had no profit stream, then it had no claim for damages arising from the claimed loss of the stream. Frazee (JRH's expert) testified that, *based upon* JRH's historic stream of profits, JRH would likely have had a certain amount of profits in the future. Pet. Opp. 24 ("Frazee used historic sales data from the past five years to estimate future lost profits."). But Frazee had no first-hand knowledge of whether JRH *actually had* a stream of historic profits. Rather, Frazee simply worked from information regarding prior sales and profits that someone at JRH gave him. Apx. 571, 604-07, 609-11, 636-37. Because he acquired the relevant information from someone else, rather than from first-hand knowledge, Frazee's statements concerning JRH's historic profits are classic hearsay. *See* Fed. R. Evid. 801. And JRH never offered at trial any documentary evidence that JRH *actually had* any lost profits, nor did JRH offer a fact witness to fill this void (e.g., no one testified that JRH ever had any historic profits or what they were). Nevertheless, over Adell's repeated objection, the bankruptcy court held Adell liable for millions in damages (far more than Adell's net worth) based on Frazee's testimony. Pet. App. 83a. As a result, JRH has succeeded (so far) in pulling off an evidentiary "fast one" -- i.e., purporting to establish a key factual element of its claim (whether it *actually had* a stream of profits that it claims to have lost) through an expert who had no idea whether the information handed to him was accurate or not. JRH's "fast one" is especially troubling because JRH resisted and failed to disclose in discovery the information that Frazee relied upon, and the evidence suggests that, due to its questionable business practices, JRH was not profitable during the relevant five-year period that JRH used to measure its historic profit stream.[1]

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[1]JRH's recitation regarding its non-disclosure of the relevant materials on which Frazee relied is incorrect. Adell sought discovery of the relevant financial records, JRH objected, and the bankruptcy court refused to require their production. Apx. 94. The month before trial began, however, the court-appointed discovery master directed JRH to produce the financial records. At trial, Adell objected to Frazee's testimony on

Again, contrary to JRH's assertions, the question presented is *not* whether Frazee could rely on the hearsay statements of some undisclosed person in forming his opinion on JRH's anticipated future profits. Rather, the question presented -- and the subject of a split among the courts of appeals -- is whether JRH could rely on Frazee's hearsay statements to establish that JRH *actually had* the stream of profits that it claims it lost. Following the First Circuit's approach, the court below answered "yes." Five other courts of appeals have answered "no." Certiorari is warranted.

A. The Decision Below Deepens A Circuit Conflict On An Important And Recurring Problem.

As the Sixth Circuit specifically recognized in the decision below, JRH "bore the burden of proving [its claim for damages]." Pet. App. 29a. Yet, expressly following the approach taken by the First Circuit in *International Adhesive Coating Co. v. Bolton Emerson Int'l, Inc.*, 851 F.2d 540 (1st Cir. 1988), the Sixth Circuit ruled that "[h]ad JRH had an independent need to prove the past profits . . ., the present record might be inadequate. However, it did not." Pet. App. 29a. In concluding that JRH properly presented proof of its past profits by offering Frazee's hearsay testimony, the court reasoned that, once JRH offered Frazee's hearsay testimony, the burden shifted to Adell to demonstrate that the information that Frazee relied upon was wrong, and that "an opposing party who would challenge the facts underlying the expert's opinion must do so by cross-examination." Pet. App. 30a Although this conclusion turns the hearsay rule on its head, it is clearly the holding of the Sixth Circuit in this case.

JRH does not deny that the Sixth Circuit reached this legal conclusion. Instead, it theorizes that a conflict among the courts of appeals does not exist for two transparently unsound reasons.

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the ground that the documents still had not been produced. Apx. 582. JRH disputed this. Yet, JRH never introduced any financial records into evidence at trial (which JRH concedes), Apx. 581-85; Pet. Op. at 8, and there is no evidence that the documents were ever produced.

First, JRH attempts to conflate the question presented with an entirely different question -- whether an expert may rely on hearsay in forming an opinion and may disclose through testimony the hearsay that he or she relied upon. JRH asserts that the courts of appeals all agree that, under Rules 703 and 705, an expert may do so, and that it is the burden of opposing counsel to explore and expose any weakness in the expert's opinion through cross-examination. *See* Pet. Opp. 24-25. But JRH's observations are irrelevant to resolution of the question presented. Frazee expressed an opinion regarding JRH's potential future profits based upon information concerning JRH's historic profit stream -- information that an undisclosed person gave to him and that was never itself introduced at trial. The question presented is whether JRH could then rely on Frazee's hearsay testimony regarding JRH's claimed historic profit stream to establish as fact that JRH *actually had* a profit stream to lose. The Sixth Circuit ruled that JRH could do so, holding that Adell had the burden of disproving the facts that Frazee relied upon. As JRH tacitly acknowledges, however, numerous courts of appeals have adopted a contrary rule – i.e., that a party simply cannot rely on such hearsay at all. Thus, a circuit split exists on the question presented and certiorari is warranted.

Certiorari is especially warranted because, as demonstrated by the decision below and the approach taken by the First Circuit in *International Adhesive*, courts often get this wrong. And they get it wrong for the very reason that JRH gets it wrong -- they erroneously confuse the ability of an expert to rely on hearsay in forming an opinion, and to disclose the basis for his or her opinion (including any hearsay on which he or she relied), with the admissibility of the expert's testimony to establish the underlying hearsay as proven fact. As a matter of law, an expert's recitation of hearsay simply cannot establish the hearsay as fact because Rule 802 provides that "[h]earsay is not admissible except as provided by these rules," and Rules 703 and 705 simply do not permit what the Sixth Circuit allowed in this case. As the Seventh Circuit has clearly explained:

> An expert is of course permitted to testify to an opinion formed on the basis of information handed to rather than

> developed by him -- information of which he lacks first-hand knowledge and which might not be admissible in evidence no matter by whom presented. Fed. R. Evid. 703. And in explaining his opinion an expert witness normally is allowed to explain the facts underlying it, even if they would not be independently admissible. But the judge must make sure that the expert isn't being used as a vehicle for circumventing the rules of evidence. . . . If for example the expert witness (call him A) bases his opinion in part on a fact (call it X) that the party's lawyer told him, the lawyer cannot in closing argument tell the jury, "See, we proved X through our expert witness, A."

In re James Wilson Assocs., 965 F.2d 160, 172-73 (7th Cir. 1992); *see also Paddack v. Dave Christensen, Inc.*, 745 F.2d 1254, 1261-62 (9th Cir. 1984) ("Rule 703 merely permits such hearsay, or other admissible evidence, upon which an expert properly relies, to be admitted to explain the basis of the expert's opinion. It does not allow the admission of the reports to establish the truth of what they assert."); *Fox v. Taylor Diving & Salvage Co.*, 694 F.2d 1349, 1356 (5th Cir. 1983) ("An expert is permitted to disclose hearsay for the limited purpose of explaining the basis for his expert opinion, Fed. R. Evid. 703, but not as general proof of the truth of the underlying matter, Fed. R. Evid. 802.").

JRH contends that the Seventh Circuit's decision in *James Wilson* is consistent with the result below. JRH is wrong. JRH concedes that, in *James Wilson*, the testifying expert could not be used to prove an essential element of the plaintiff's claim -- the condition of a building -- because the expert's knowledge of the condition of the building was based on hearsay. 965 F.2d at 173. JRH's concession is fatal to its attempt to harmonize the case with the one at bar.

Consistent with *James Wilson* and the Rules of Evidence, Frazee could testify about his opinion on future losses, but could not establish as a fact that JRH *actually had* any historic profits, or what those profits were, because Frazee did not have any first-hand knowledge about them. Nonetheless, the courts below allowed this, and placed the burden on Adell to disprove what Frazee

assumed. This approach clearly conflicts with that taken in *James Wilson*. 965 F.2d at 172-73. As the Seventh Circuit warned, "[t]he fact that inadmissible evidence is the (permissible) premise of the expert's opinion does not make that evidence admissible for other purposes, purposes independent of the opinion." 965 F.2d at 173 (citation omitted).

JRH's attempt to distinguish the Tenth Circuit's decision in *TK-7 Corp. v. Estate of Barbouti*, 993 F.2d 722 (10th Cir. 1993), also fails. There, the issue was lost profits, and a "non-testifying expert" (Werber) had calculated sales projections that were relied upon by the "testifying expert" (Boswell). The Tenth Circuit rejected Boswell's testimony, emphasizing that the "expert" could not be used to prove facts necessary to the underlying claim. 993 F.2d at 732. The Tenth Circuit also recognized that allowing an expert to testify as to the underlying facts, and then allowing the adverse party an opportunity to cross-examine the expert, was improper as a means to admit the hearsay to prove its truth: "Dr. Boswell's lack of familiarity with the methods and the reasons underlying Werber's projections virtually precluded any assessment of the validity of the projections through cross-examination of Dr. Boswell." *Id.* at 732-33. Similarly, here, Frazee had no first-hand knowledge of the underlying data upon which he relied and could offer no testimony as to its accuracy, thus precluding meaningful cross-examination.

JRH asserts erroneously that the Fifth Circuit's decision in *Viterbo v. Dow Chem. Co.*, 826 F.2d 420 (5th Cir. 1987), follows the same approach as the court below. On the contrary, the court concluded in *Viterbo*: "Dr. Johnson's testimony is no more than Viterbo's testimony dressed up and sanctified as the opinion of an expert. Without more than credentials and a subjective opinion, an expert's testimony that 'it is so' is not admissible." 826 F.2d at 424. Because of these deficiencies, the Fifth Circuit excluded the expert's opinion entirely and directed summary judgment in favor of the defendant. *Id.* at 425. Contrary to JRH's mischaracterization, the Fifth Circuit's decision in *Viterbo* illustrates only the depth of the conflict among the courts of appeals on the question presented. In this case, the court below

approved JRH's use of Frazee's testimony to establish that it had historic profits even though JRH simply told Frazee that "it is so." In *Viterbo*, the Fifth Circuit rejected this approach unequivocally.

None of the other cases that JRH cites or discusses, *see* Pet. Opp. at 25, undermine Adell's demonstration of a circuit conflict. For example, none involved the use of hearsay testimony, through an expert, to prove a necessary fact. *See Walker v. Soo Line R.R. Co.*, 208 F.3d 581, 586 (7th Cir. 2000) (expert's methodology in assessing IQ at issue under *Daubert* analysis); *United States v. Elliott*, Case No. 94-10378, 1996 WL 380482 at *3 (9th Cir. July 5, 1996) (unpublished) (use of hearsay report in cross-examination); *Robinson v. Missouri Pac. R.R. Co.*, 16 F.3d 1083, 1090 (10th Cir. 1994) (expert's qualifications and conclusions questioned); *Mitchell v. Lone Star Ammunition, Inc.*, 913 F.2d 242, 252 (5th Cir. 1990) (expert's conclusions -- confirmed by five additional witnesses -- were questioned).[2]

Moreover, one of the other cases that JRH cites -- *South Central Petroleum, Inc. v. Long Bros. Oil Co.*, 974 F.2d 1015 (8th Cir. 1992) -- only illustrates further the conflict on the question presented. In *South Central*, the data on which the expert relied was disclosed and admitted into evidence at trial by way of a spreadsheet exhibit. 974 F.2d at 1019. The Eighth Circuit, however, allowed the data to explain the expert's conclusions, not to establish as true the underlying facts, stating: "When the district court admitted the exhibit, however, it limited the admission to the expert's opinion, and not to the underlying figures, as required by Federal Rule of Evidence 703." *Id.*

Second, in response to Adell's demonstration that the decision below follows the approach taken by the First Circuit in *International Adhesive*, JRH bizarrely mischaracterizes the First

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[2] Likewise, *Zayre Corp. v. SM&R Co.*, 882 F.2d 1145 (7th Cir. 1989), cited by JRH, is irrelevant. The portion of *Zayre* that JRH cites concerns the authentication of documents and summaries of documents under Fed. R. Evid. 803(6), 901(b)(9), and 1006. 882 F.2d at 1149; Pet. Opp. 8-9.

Circuit's approach as adhering to the rule that "a proponent of expert testimony cannot rely upon a hearsay fact to establish the truth of the fact through the expert." Pet. Opp. 24. Contradicting this very assertion, JRH also expressly concedes that the rule that the First Circuit follows is that a litigant may use the hearsay testimony of an expert to establish underlying facts, and that the hearsay nature of the testimony goes "to the weight of the testimony, not its admissibility; opposing counsel had the opportunity to expose any weakness through cross-examination." Pet. Opp. at 24 (citing *International Adhesive*, 851 F.2d at 545).

In *International Adhesive*, an expert testified regarding claimed losses, basing his opinion on business and financial records and interviews with personnel. 851 F.2d at 545. The defendant challenged the testimony, arguing that there was no documentary proof in the record to support any claimed losses. *Id.* Rather than require the plaintiff to demonstrate its *past* profits independent of the expert's opinion regarding *future* losses, the court mixed these two separate components of proof together, stating: "When the factual underpinning of an expert's opinion is weak, it is a matter affecting the weight and credibility of the testimony -- a question to be resolved by the jury." 851 F.2d at 545. In doing so, the court allowed past profitability to be assumed as "built in" to the expert's opinion, which was itself based on hearsay.

Obviously, the First Circuit's approach is the same as the Sixth Circuit's approach in this case (which explains why the Sixth Circuit expressly relied on *International Adhesive* in its relevant holding in the decision below). In turn, the decision of the Sixth Circuit in this case and the decision of the First Circuit in *International Adhesive* both conflict with the decisions of numerous other courts of appeals on the question presented. Accordingly, certiorari is warranted.

B. The Decision Below Conflicts With Prior Decisions Of This Court And Is Plainly Wrong.

JRH does not deny that Frazee's testimony concerning JRH's historic profit stream is classic hearsay. Nor does JRH deny that Frazee's testimony is inadmissible under Rule 802 to prove that JRH actually had any historic profits. Indeed, JRH has no response

at all to Adell's demonstration that the decision below conflicts with prior precedents of this Court and is plainly wrong. For this additional reason, certiorari is warranted.

C. This Case Presents An Ideal Vehicle To Resolve The Conflict Among The Courts of Appeals.

Finally, JRH's suggestion that resolution of the question presented is not outcome-determinative is also wrong. JRH suggests that, even if Frazee's testimony is inadmissible, JRH otherwise proved the existence of its historic profits through Shekerjian's testimony. This response fails for two reasons.

First, the Sixth Circuit plainly did not accept JRH's argument. After independently reviewing the entire record, the court concluded that "[h]ad JRH had an independent need to prove the past profits . . ., the present record might be inadequate." Pet. App. 29a. The court, however, avoided holding that JRH failed to meet its burden on the existence of past profits by applying the legal rule that, once Frazee testified on this issue, the burden shifted to Adell to disprove the facts underlying Frazee's testimony. If JRH had truly established its past profits through Shekerjian's testimony (or in some other way), the Sixth Circuit would have ruled accordingly and avoided completely the controversy over the inadequacy of Frazee's testimony on this issue. The court did not do so, however, suggesting only that the record demonstrates that JRH did not offer any other evidence to support its claim of past profits.

Second, the record clearly demonstrates that JRH did not, in fact, offer additional testimony to fill the evidentiary void on claimed past profits. In tacit recognition of the weakness of its assertion that it did, JRH only half-heartedly argues that Shekerjian's testimony proved its historic profits, rendering harmless the inadmissibility of Frazee's testimony. Pet. Opp. 4. At most, however, Shekerjian testified regarding "historic" figures only in the most vague and cursory fashion. Critically, his testimony did not mention, let alone establish, *any* past earnings figures, profits, or profit margins, or any relevant financial basis for determining whether JRH was ever profitable in any sense. Tellingly, JRH does not provide a single record citation to demonstrate that Shekerjian actually even mentioned in passing

what JRH's profits were at any point in time, let alone the basis for any such conclusion. In fact, the record demonstrates that Shekerjian's testimony at trial amounted to nothing more than such statements as "Yeah, I believe so" in response to leading questions from JRH's attorney regarding *Frazee's* testimony. *See* Apx. 0635 (*Q*: "Is the 17 percent margin that Mr. Frazee projected . . . consistent with your own experience . . . ?" *A*: "Yeah, I believe so." *Q*: "And that's based on what?" *A*: "Historical information. I mean, just, you know, 20 years in the business . . . ."); Apx. 0668 ("I – I wasn't involved in that aspect of it. I'm not in the accounting side of the business at all."). Shekerjian's testimony is wholly insufficient to prove unmentioned past profits, and the sheer length of JRH's discussion of his testimony cannot hide its lack of substance.

JRH cannot avoid certiorari on the basis of an unfounded assertion regarding Shekerjian's testimony that the court below did not accept or decide, and that the record does not support. *See Cooper Indus., Inc. v. Aviall Servs.*, Inc., 543 U.S. 157, 168-69 (2004) ("'We ordinarily do not decide in the first instance issues not decided below.'") (quoting *Adarand Constr., Inc. v. Minetta*, 534 U.S. 103, 109 (2001). At the very most, the question whether JRH met its burden of demonstrating the existence of past profits other than through Frazee's testimony would be an issue for remand. JRH's assertion offers no basis to refute the clear conflict among the courts of appeals on the question presented, or the clear error of the court below in accepting Frazee's hearsay testimony to satisfy JRH's burden on the issue whether JRH *actually had* any historic profits that it claims it lost.

CONCLUSION

For the foregoing reasons, together with those set forth previously, Petitioner respectfully requests that the Court issue a writ of certiorari in this case.

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